PROHIBITING BRIBES TO FOREIGN OFFICIALS

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS UNITED STATES SENATE

NINETY-FOURTH CONGRESS

SECOND SESSION

ON

S. 3133

TO AMEND THE SECURITIES EXCHANGE ACT OF 1934 TO REQUIRE ISSUERS OF SECURITIES REGISTERED PURSUANT TO SECTION 12 OF SUCH ACT TO MAINTAIN ACCURATE RECORDS AND TO FURNISH REPORTS RELATING TO CERTAIN FOREIGN PAYMENTS, AND FOR OTHER PURPOSES

S. 3379

TO REQUIRE REPORTING AND ANALYSIS OF CONTRIBUTIONS, PAYMENTS, AND GIFTS MADE IN THE CONDUCT OF INTERNATIONAL BUSINESS, AND FOR OTHER PURPOSES

S. 3418

TO AMEND THE SECURITIES EXCHANGE ACT OF 1934 TO PROHIBIT CERTAIN ISSUERS OF SECURITIES FROM FALSIFYING THEIR BOOKS AND RECORDS, AND FOR RELATED PURPOSES

MAY 18, 1976

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CONTENTS

List of Witnesses

APPENDIX

PROHIBITING BRIBES TO FOREIGN OFFICIALS

TUESDAY, MAY 18, 1976

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS,
Washington, D.C.

The committee met at 10 a.m. pursuant to notice, in room 5302, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee), presiding.

The CHAIRMAN. The hearing will come to order.

This morning the Banking Committee resumes hearings on foreign corporate bribery and proposed remedial legislation, S. 3133; S. 3379; and S. 3418. Our witnesses are the four SEC Commissioners. Last week the Commission provided the Banking Committee with the SEC's first comprehensive report on the corporate bribery scandal,* and I know the committee has been looking forward to the opportunity to discuss some of the findings with the Commissioners in greater detail.

I read the report with mixed emotions. On the one hand, nearly 100 corporations have come forward under pressure from the Commission's so-called voluntary disclosure program, and admitted various degrees of improper foreign and domestic payments. Presumably, the ordeal of these disclosures will have an inhibiting effect on corrupt corporate practices. On the other hand, many of the disclosures leave out more than they tell. In a revealing footnote, the report admits that it is not even possible to tell from some of the filings whether the reported payoffs were foreign or domestic. The disclosures are still incomplete. On the one hand, the report says the Commission supports the philosophy behind S. 3133. On the other hand, you don't support the bill. I am delighted that the Commission now recognizes the need for remedial legislation. However, the Commission's own proposal, which I introduced last week as S. 3418, would merely codify the requirement that a corporation keep honest records, a requirement that is at least implicit in the entire system of corporate accountability. I am curious to learn what that bill gives you that you don't have already.

On the one hand, the Commission provides in its report some loose guidelines on what kind of questionable foreign payments must be disclosed under existing law, based on the materiality doctrine. On the other hand, the guidelines are very elastic. They remind me of the comment attributed to a Supreme Court Justice about pornography—I can't define it, but I know it when I see it. The SEC seems

*"Report of the Securities and Exchange Commission on Questionable and Illegal Payments and Practices." Committee Print, Senate Banking Committee, May 1976.

to be saying that they can't quite define what sort of bribe is material under existing law, but they know it when they see it.

I would submit that, unlike pornography, a bribe is fairly easy to define. In S. 3133, we define it as a payment to an official of a foreign government for the purpose of inducing him to use his influence to secure business for the issuer or influence legislation or regulations of his government.

Other definitions, of course, are possible, and I hope that the SEC will work with the committee to devise a workable definition. Of the three bills before the committee, the SEC measure is the weakest. It provides simply for honest recordkeeping. My own bill, S. 3133, not only outlaws foreign bribes, but also requires disclosure of all foreign sales commission payments. Senate bill 3379 sponsored by Senators Church, Clark, and Pearson of the Multinationals Subcommittee, of the Foreign Relations Committee would require disclosure of both foreign government and commercial bribes, and would also provide for private lawsuits, and the mandatory establishment of independent audit committees of corporate boards of directors, regular reports to Congress by the Secretary of State, and would make clear that bribes are nondeductible for tax purposes.

After nearly 2 years of analysis and investigation, a consensus seems to be developing that some legislative remedy is needed. Mandatory disclosure is the most obvious common denominator. Senator Church, as chairman of the Multinationals Subcommittee, supports that approach. So do I; so does the SEC, although you contend that you have sufficient authority under existing law. I would submit that your report casts substantial doubt on whether existing law is sufficiently clear on just what needs to be disclosed. And I hope we can begin a full and frank discussion on that question this morning.

There's one other element of this, gentlemen, that bothers me. It seems to me that in our system of justice that we properly try to have a system that punishes those who engage in any kind of violent crime, who engage in violence against persons or seizes property that's not their own. That crime may not be subject to any kind of prior planning. It may be a matter of the emotions. Yet those who engage in it are subject to very severe penalties, or at least may be. I think that's right.

On the other hand, here we have a situation where engaging in this kind of clearly unethical and damaging action, damaging to the society, is engaged in after the most premeditated kind of planning involving a number of people in almost every case well educated people from whom we expect the highest kind of ethical conduct or at least a high kind of ethical conduct, and yet somehow we can't bring ourselves, at least the executive branch can't seem to bring itself to a clear-cut definition of this action as illegal and then take effective action to prevent it.

Chairman Hills, you have a very concise brief statement and if you would go right ahead with it and if you want to elaborate on it in any way you can do that, and then I will get to questions.

STATEMENT OF RODERICK M. HILLS, CHAIRMAN; IRVING POLLACK, COMMISSIONER; JOHN R. EVANS, COMMISSIONER; AND PHILLIP A. LOOMIS, JR., COMMISSIONER, SECURITIES AND EXCHANGE COMMISSION

Mr. HILLS. Thank you, Mr. Chairman.

The Chairman is familiar with the members of the Commission Mr. Pollack, Mr. Loomis and Mr. Evans.

On behalf of us, I must say that we appreciate this opportunity to testify further on the matter of questionable or illegal corporate payments and practices. Our detailed summary gives you our notions of what we have found; what we think the problem is; and our legislative proposals to deal with that problem. I would like only to add a few words of emphasis.

Our examination of some 100 companies has led us to conclude that the matter of illegal or questionable foreign payments is not an isolated problem. Instead, it is sufficiently widespread to be a matter of deep concern to the Commission and to the Senate.

The problem from the perspective of the Securities and Exchange Commission is that our system of corporate self-regulation, advised by independent auditors and outside counsel and ultimately enforced by the SEC, has been frustrated. We found in case after case that millions of dollars of corporate funds have been inaccurately recorded on corporate books and expended by a small number of corporate executives for questionable or illegal purposes, at home and abroad. In general, these payments have been successfully concealed from the outside auditors, sometimes from top management, and almost always from the outside directors. The fact that only some 100 of the more than 9,000 publicly traded companies required to report with the Commission have so far been found to have engaged in these practices and that only a score or so of that number have made large payments of an illegal nature seems to us not to be the critical factor. Instead, the fact that so many companies have been able to elude the system of corporate accountability strikes us as a matter requiring significant action.

It is, we think, of the utmost importance that we take steps to correct the deficiencies in the system that has served us well over the years. It is to that end that our proposals are directed.

First, we request legislation to require that corporations establish internal controls that reasonably assure the proper identification of financial transactions and prohibit corporate officials from making false or misleading statements to the auditors or creating false or misleading reports.

Upon the passage of that legislation, we would, of course, impose a requirement upon the outside auditors that they certify the adequacy of such controls. Moreover, we already have asked the New York Stock Exchange to consider whether they can change their listing requirements to require establishment of truly independent audit committees in the boards of directors of our largest corporations, and to consider

whether the Exchange can do more to create a truly independent character in those boards of directors.

Mr. Chairman, this has been an unhappy chapter for American business. We consider it important, however, to stress that we have not found in our review that bribery is a necessary or material factor to the success of American business. Indeed, we find in every industry where bribes have been revealed that companies of equal size are proclaiming that they see no need to engage in such practices. We also consider it particularly significant in view of the Chairman's comments that, with only a handful of exceptions detailed in our report, when the boards of directors of companies have been confronted with the questionable practices of their own companies, they have declared their intention to stop them and have taken effective steps to do so.

It is important, Mr. Chairman, to indicate that we continue to have faith in the system of self-regulation that has existed all these years, and we think that adoption of our proposals will give both the business community and our Commission the capacity to restore the damage done to the integrity of the system. More specifically, Mr. Chairman, we believe that the proposals we have made will encourage an accountability within the corporate structure which will assure that these matters are considered at the most responsible level of the corporate hierarchy. And, as I have indicated, our experience with so many companies has been that, faced with the need to decide whether a compelling reason to make some form of payment exists, almost without exception the boards of directors have rejected these practices, declared and effectuated their intention to stop the payments, and indicated that the payments previously made were not a material factor in their business.

As you have noted Mr. Chairman, Mr. Justice Stewart's standard for pornography is indeed an apt one for determining the propriety of these practices. There is, as you have recognized, some uncertainty in this area. But we think it appropriate to recognize, Mr. Chairman, that the disclosure of material facts and the maintenance of the integrity of corporate financial records are matters of the utmost concern to the Commission. We must focus on questions of materiality, however difficult a standard that may be. The problem that we see—the problem that I trust the committee and the public sees as well—is not the immaterial small payments made in reaction to some form of lower level extortion or in response to other possible corporate problems. The real problems we face center around the large, somewhat vulgar actions of some corporate officers who have totally ignored the system. Our effort is to stop those practices and to tell the American business community that those finding some reason to go forward with some form of payment of a questionable nature proceed essentially at their peril. If that kind of payment has a material relation to their business, foreseen or unforeseen, its nondisclosure means that they have violated the securities laws of the United States.

It is universally difficult for us to give a precise definition of what is or what is not material in this and so many other areas, just as it is difficult for judges and lawyers to decide in other contexts what is or is not reasonable. Moreover, it is not, we think, terribly helpful to define the precise area of materiality so that people can proceed with impugnity to act within that narrow confine.

Let me repeat, the problem as we see it is the breakdown in corporate accountability. It is for that reason we have asked for legislation that will address the problem we have so far encountered.

[Chairman Hills statement as submitted follows:]

STATEMENT OF RODERICK M. HILLS, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION

Mr. Chairman, members of the committee, on behalf of the entire Commission, I wish to thank the Committee for the opportunity to testify on the question of questionable and illegal corporate payments and practices. The Commission's report on this subject was submitted to this Committee last week. It provides a detailed summary of the activities conducted by the Commission, the Commission's conclusions with respect to the problems uncovered, and our legislative proposals. I will only add a few words of emphasis in my opening remarks.

Our examination of the approximately 100 publicly traded corporations that have publicly revealed questionable or illegal payments has caused us to conclude that the problem is a serious one, and one that is sufficiently widespread to be a cause for deep concern.

The problem from our perspective is that our system of corporate self-regulation, advised by independent auditors, outside directors and counsel and ultimately enforced by the Securities and Exchange Commission, has been frustrated. In case after case millions of dollars of corporate funds have been inaccurately recorded on corporate books and records and expended by a small number of corporate executives for questionable or illegal purposes at home and abroad. In general, the payments have been successfully concealed from the outside auditors, sometimes from top management and almost always from the outside members of the Board of Directors.

That only 100 of approximately 9,000 publicly traded companies subject to our reporting requirements have so far been found to have engaged in such practices and that only a score or so of that number have made very large payments are not the critical factors. If companies of such size can evade the system of corporate accountabiilty, then any company can do so. It is of the utmost importance, therefore, that we take steps to correct the deficiencies in the system and our legislative proposals are addressed to that end. They would:

Require that corporations establish internal controls that reasonably assure the proper identification of financial transactions.

Prohibit corporate officials from making false or misleading statements to the auditors.

At the same time we have asked the New York Stock Exchange to consider whether it should take steps to create a truly independent character in the board of directors of our largest corporations.

This has been an unhappy chapter for American business but it is important to stress the point that we have no evidence that bribery is a material factor in its success. Indeed, in every industry where bribes have been revealed, we see companies of equal size in the same industry proclaim that their corporations compete fairly without bribes.

It is equally significant that with only a handful of exceptions the boards of companies that have been faced with their own questionable past practices have declared their intention to stop them.

Most important, we continue to have faith in the system. The adoption of the proposals we suggest will give the business community and this Commission the capacity to restore the damage that has been done to its integrity.

The CHAIRMAN. Thank you very, very much. I think that what you said is very useful and you have said much of it of course in your report. You have pointed out that this practice has been widespread. You assert here now, as you did in your report, that you found it's not a necessary or material factor in the success of these firms and in every industry where bribes have been paid you found that other firms have been able to succeed without following that policy.

Now it seems to me that this should be just an easy solution for us. I just cannot understand under these circumstances, in view of the fact

72-525 O - 76 - 2

that we say bribes are not necessary or material to the success of a business, and in every industry we have had success without paying bribes, why not outlaw it? And the argument on the other side has always been, well, let's be practical. We don't want to hurt our balance of trade. We want to be able to sell abroad. We won't be able to sell maybe if we don't conform to the practices in foreign countries. I think you have answered that exceedingly well.

You pointed out that bribes by American corporations abroad are widespread and yet we don't seem to have a clear-cut comprehensive prohibition of improper foreign payments.

Mr. HILLS. Mr. Chairman, let me say with some emphasis that I am personally convinced, and I believe the Commission is entirely convinced, that the measures we are taking, aided by this form of legislation, will stop the bribe of a foreign official to get business.

The CHAIRMAN. Well, I hope so. You see, what bothers me about that is, as you say, you have faith in the system that it will work, and I would like to have as much faith as I can; but the fact is it has not worked. You say it's widespread now, this bribery is. We found situation after situation where there may be a great deal of protest for a while based on exposure in the newspapers and the press generally and then it dies down. Then we go back to the old unfortunate corrupt ways—and it's hard for me to see what in your proposal would change the situation sufficiently to rectify that.

Mr. HILLS. Mr. Chairman, the responsibilities we seek to impose by legislation and the Commission's actions to impose responsibilities on the advisory ssytem the independent auditors and outside directors and counsel will, in our judgment, stop these practices. After all, we are talking about practices that, in our judgment, when brought to the attention of the appropriate level of management have been stopped. The fact that the new sense of responsibility is being placed upon the system to make it accountable and to create greater penalties will, in our judgment, make the system work to eliminate the kinds of payments we have discussed in this room before—the kinds of payments this committee has been concerned with.

The accounting profession has responded, we think, as it should have. One can quarrel with the question of whether the accounting profession should have been more alert to the problem in the past. That seems to be immaterial today, however. The accounting profession now is moving forward. We have pointed out that the Auditing Standards Committee of the Executive Committee has proposed a draft which would specifically articulate the responsibility of auditors to bring all illegal payments to the attention of management that is sufficiently powerful to take care of the problem.

We have made it quite clear to management of American business that we cannot asume they have the authority from their boards of directors to make any kind of illegal payments. We have challenged the capacity of a businessman to do something illegal; regardless of whether he considers it in the best interest of his company and regardless of how small the infraction might be.

There are some ambiguities in the smaller, so-called immaterial payments, the problems of identifying the kind of pressure that may have existed, problems of interpreting foreign laws—matters we are forcing boards of directors of those companies to wrestle with. I don't think

that this committee is primarily concerned with the isolated payment, designed to free some goods in response to some form of small extortion. I think we are concerned with the fact that some American companies have been shown to have depended upon illegal payments to maintain their very business abroad, that they have depended on bribes and grease rather than price and product for their business. Those are the practices that I think we can stop. Those are the practices I think we have largely stopped already through the efforts of our Division of Enforcement, and I am certain the chairman appreciates that the integrity of the Commission, its Division of Enforcement, and its Division of Corporate Finance are important safeguards. We will not loose interest or resolve to deal with these problems, even after they slip from the primary focus of media attention.

The CHAIRMAN. In your report to the Banking Committee, this report that you have made which is a very interesting report, your discussion of when foreign payments must be disclosed is very ambiguous. You say that the size of the payment can govern whether it needs to be disclosed. But apart from the size of the payments the payments should be disclosed to shareholders if their clandestine character raises questions about the quality of management. You say there can be no simple litmus test because each case represents a unique combination of facts. Your discussion of disclosure is full of hedge words—"off the book accounts," generally you say, not always, but generally require disclosure. Apart from size, if the payment is illegal under foreign law, disclosure may be required. You don't say is required; you say may be required. Illegal political contributions may be material if they are intended to unduly influence policy decisions. So-called facilitating payments have been deemed to be material if they are large or if the management conceals them and so forth.

Now that's all very ambiguous. Why not simply require disclosure per se as required in S. 3133? Why not just say it has to be disclosed and not have all this folderol about "maybe, perhaps, generally," and so forth?

Mr. HILLS. Mr. Chairman, even though the accounting profession is more precise than my own profession, the fact remains that many arguments can be made about what is and what is not a proper accounting, what are proper books and records. Problems of intent, problems of purpose, problems of size are all matters which the legal and accounting professions and, of course, this Commission must deal. I might note that those files on these practices have been and are available to the staff of the committee, and I submit that the ambiguities which may exist with the kinds of matters you properly characterize as hedged in our report are not unique problems facing American business today. Those are the kinds of problems of ambiguity that exist in every business enterprise and every aspect of the law. Those problems may persist.

I don't think we can assert that we know the ultimate truth concerning business practices abroad. But with respect to what we have seen, the some 130 cases that have passed through the Commission in one form or another, the approach I have outlined will eliminate what we consider a pressing problem. More important, the measures we suggest are consistent with the Commission's tradition, namely, to assure that the financial and narrative statements of a company accurately inform the public as to all material matters.

We have struggled since I have been Chairman of this Commission and the Commission has struggled for many years prior to that time, to try to find a precise definition for the word "materiality." That, however, is not the real issue before this committee. The question is, can we be reasonably certain when this kind of legislation is on the books that the problem that we perceive has been solved? If it is not, the efforts of the Division of Enforcement will continue to focus on this problem, and our files and records will remain available to the staff of this committee as a basis for determining whether further measures should be taken. I hope you and the staff will agree as you go through these files that we have taken appropriate action on a case-by-case basis to require the kinds of disclosure to identify to investors and shareholders the practices the Chairman is concerned with.

The CHAIRMAN. Well, I think your answer emphasizes the point I want to make about relying on materiality. I'm concerned that hanging the entire Federal policy against foreign corporate bribes on the materiality concept introduces unnecessary distortions to the policy. For example, you say on page 6 of your report, commenting on S. 3133, that disclosure of the identity of a recipient of a bribe is probably unnecessary because it may be of little significance to the investor.

That is precisely the problem with tying it to materiality. It may indeed be immaterial to the investor. There is nonetheless a very good justification for a public policy requiring disclosure of the recipient of a bribe. The purpose is simply to inhibit the bribe in the first place. But by tying it to materiality in every case it becomes necessary to disclose a different defense which is really not material to our purpose here. You see my point?

Mr. HILLS. I do indeed, Mr. Chairman, and it would be wrong for me to try to comment on policies Congress might wish to enact that transcend the area of responsibility of the Securities and Exchange Commission. For example, there are four cases detailed in this report where corporations have stated that, where unavoidable, they will continue to make certain kinds of payments. If Congress were to decide that American corporations should not, even under those circumstances, be permitted to make those kinds of payments, then of course Congress can enact that judgment into law.

If I may speak for a moment as a former businessman, there are problems of an excruciating nature where you have to choose between accepting serious damage to property of the stockholder or yielding to some form of low level extortion. Personally, speaking as a former businessman, I see no reason to go into a buisness climate in which you know you will be confronted with that problem. But companies that conduct business throughout the world sometimes find they cannot operate in certain parts of the world without facing these choices.

As the Chairman knows, where foreign laws are violated, this Commission has always cooperated with foreign governments to provide the evidence in our possession that those governments may need to enforce their own laws. Our responsibility is to find out what corporate officials do. We have neither the capacity nor the jurisdiction, and perhaps no American Government agency can have the jurisdiction, effectively to determine everything that happens in a foreign country as to assess the legality of that conduct under foreign law. But, I think we can stop the abhorrent conduct of American corporate officials we have seen.

If the residual kinds of practices persist, and, as I have said, we have outlined the four cases we have found so far where businesses have told us they may have to make some questionable payments in the future to meet local needs they spelled them out, we will continue to discover those matters out because the system of corporate accountability will bring them to the surface.

I think that if Congress can do what we ask—prepare and equip the business community and the professionals, that advise it to take the kinds of actions we expect of them—our Division of Enforcement and Corporate Finance and our accounting personnel will police the system and provide a thorough and balanced record for the Congress. If the system we seek to establish is not adequate to the task, and if the problems persist, we will find them and bring them to your attention. Congress can then proceed to eliminate these practices outright if it chooses.

I think that our response is a measured one, one that meets the problem we perceive. We think it represents a responsible reaction to the real problem of questionable and illegal foreign payments and practices.

The CHAIRMAN. Now let me ask each of the other commissioners to respond to the question on whether or not we should hang as much of this policy on materiality; that is, require that there be disclosure when the matter is material to the investors. Starting off with Mr. Pollack and then going across.

Mr. POLLACK. I think first, Mr. Chairman, we ought to point out that the report which you received and the actions which we have taken in uncovering this problem and in dealing with it were all done under the framework of the existing securities laws. To that extent, I expect we can state that the existing laws did provide us with the basis upon which we could take action against those businesses that have engaged in the conduct and, indeed, I expect one of the more optimistic things that we can take from what we have done is that we were able with minimum resources, using the strength of the private sector and the private sector which had engaged in these activities, to undertake the corrective action in cleansing the enterprises and in uncovering the past conduct and in bringing it out to the investor and the public through disclosure through our actions or through the voluntary programs that were started or engendered by the Commission's suggestion.

I state that because as we are discussing corrective legislation we may overlook what has been accomplished by the Commission with very minimal resources, very minimal.

The CHAIRMAN. Let me just interrupt to say I think that's a very, very good point. I think the Commission has done a good job. I didn't mean to indicate by my statement that the Commission has been asleep. In fact, it's the only Agency that has not been asleep. It's done a good job here. There's more to do and we are talking now about what law we should have.

Mr. POLLACK. I agree and I ought to state at the outset that we recognize that in a problem that's evolving and as complicated as this one and involves international relations and international diplomacy, that we probably don't have the answer to all of the questions and final judgment. I expect what we have endeavored to do was within the

purview of the SEC from the SEC's viewpoint to look at the problem as it evolved and recommend those steps which we feel again within the SEC framework would give us the additional support that we need to hopefully not eliminate the problem—I don't think you ever will—but certainly to place it under control.

For that reason, I expect that we felt putting together the four steps that we have taken would, from the SEC's viewpoint, at least at the start provide an answer to the problem as we see it. If we are wrong or if people feel after considering these other issues that I have mentioned where other agencies of Government may be much more sophisticated or intelligent in those areas than we are, for I fear sometimes that we don't know all the consequences, particularly when we're dealing in the international framework of what can happen—and so I expect that what we have said in our comments in our report was with respect to the broader measures that you have questioned Chairman Hills on, that those we feel require exploration beyond where we feel confident as experts in suggesting a legislative program to deal with the problem.

Second, I expect we feel that our program should eliminate to the extent that we have at least experienced it the problems as we saw them.

With respect to the materiality, I think there has been some confusion. We are not speaking of materiality here in the sense of 1 or 2 percent of sales, as it might apply in ordinary business that is done in a regular and legal way. We are talking here about materiality in the sense of waste of corporate assets. Where a corporation engages in conduct of illegal or questionable payment, as the Chairman has stated, they act at their own peril. If they are wasting corporate assets, there is a duty, as we perceive it—or at least as I perceive it as an individual, that appropriate disclosure be made.

Now certainly there's a de minimus standard and that I think neither you nor we would be concerned with. So I think under the framework that we have suggested, once you get an honest count on the corporation, once you place the responsibility on those who are managing the investors' moneys, those who are fiduciaries for the investor, if they should continue to engage in this conduct, in addition to the honest records, in addition to the internal controls, they would then be faced with the peril decision. Do they have a responsibility of disclosing to their shareholders and to the public that they have engaged in what you and we would consider to be material questionable or illegal payments?

The CHAIRMAN. I would think from the standpoint of the corporations involved, they would be better off by just saying disclose it. You say if you had 1 or 2 percent of sales—that, I agree, wouldn't be a satisfactory method of measure of materiality and you discard that—you have something called waste of corporate assets. Well, what is that? You know, that's a lot less precise and specific and understandable and clear, both to the corporation and the public than 1 percent of the sales or percentage of profit or whatever.

Mr. POLLACK. But, in essence—that's correct, but in essence, what you're dealing with when you're dealing with integrity and honesty, you're dealing with some of those questions. Am I dishonest if in order to get——

The CHAIRMAN. Why not require the full disclosure the way we do it in our bill?

Mr. POLLACK. Well, I think, for example, you have a $1,000 limit as I recall in your bill.

The CHAIRMAN. Right.

Mr. POLLACK. And I must say in all candidness that even $1,000 may be too high depending on the circumstances under which a particular payment is made.

The CHAIRMAN. Supposing we gave the SEC authority to go below that?

Mr. POLLACK. I don't think you can set a dollar figure. That's what I'm saying to you. I think what you come to, once you have made an honest count of a business operation and you're able to look at it in the overall circumstances—the Chairman has mentioned four cases where people have said that we recognize that the payments that we have made may be questionable or illegal; we feel however in the particular area that we operate under, their customs, under their mores, that we must do this in order to conform to their method of doing business—I say in that case, yes, if they are going to continue to do that, from our point of view, they should disclose it and if they are right that that's the way business is done there there will be no retribution against them. If they are wrong, there will be retribution against them because I expect those that are in the particular country where they do business will take action against them.

I think we ought to emphasize—or at least I ought to emphasize that we have presented you with a program. I don't think that anyone here is saying that your approach is perhaps wrong and ours is the only right one. I think what we are saying is that we feel confident with our approach that it will deal with the problem, perhaps not in as draconian a fashion as other measures, and that we ought to try this approach. If this approach doesn't work, we could use your approach or other approaches that have been suggested.

In any event, the other approaches seem to us to raise much broader international questions and national policy questions than we felt confident in dealing with and that is the reason why I think we came up with our particular proposal.

The CHAIRMAN. All right, let me ask Mr. Evans, and I'll sharpen my question a little bit by saying supposing we require disclosure of all foreign payments as we indicate in our bill of $1,000 or over and then under that wherever the SEC felt that it is material require that the disclosure be made, too.

Mr. EVANS. Let me try to respond generally and specifically if I can, Mr. Chairman. I think that it is extremely difficult for the SEC to try to give you an answer as to what is appropriate for the Congress to do. I don't believe we are in a position to do that. I do, however, believe we can tell you what we think is appropriate for investor protection.

The CHAIRMAN. You can do it if we ask you, and I'm asking you what you think. We can accept it or disregard it. You served on this committee on the staff brilliantly for years and you understand what our limitations are and we have to look to the real experts in the area and in this area certainly the SEC is more expert than any member of the committee or the committee staff.

Mr. EVANS. We can accept that compliment when it comes to investor protection and our responsibilities under the securities laws. We cannot accept it, however, when it comes to such things as our foreign relations and some of the other factors which obviously you must consider in making this decision. When it comes to investor protection, we try to give you the best advice we can.

It may well be that for securities law purposes the case of a $1,000 payment is immaterial in some instances. In others it may be very material. Now you have suggested that we have given you guidelines or guidance which is very imprecise in our report. That imprecision is intentional. In my opinion, that is the only kind of guidance we should give in an area like this. We should not tell people that a payment of a certain amount is immaterial in all cases, or that they can make a payment of any specific size without disclosure because a payment may well be important, even though it's very small. Moreover, there are ethical and moral considerations here which aren't necessarily part of the securities laws, and I don't believe the Commission should be in a position of appearing to condone illegal or questionable payments of any size.

The CHAIRMAN. Fine, why not have the $1,000, as I say, and require that disclosure, and then below that have the discretion or flexibility you're calling for?

Mr. EVANS. If you require disclosure of all $1,000 payments individually in corporate reports, including the name, every person involved, this could be very voluminous, burdensome, and could include some things that are very unimportant. In other words, such a precise standard is unnecessary because there may be cases in which $1,000 is very important to investors.

Now secondly, it seems to me that disclosure of the type we're requiring and what we have seen occur as a result of the actions we have taken has been very beneficial to the business community. In many cases we have seen people disclose far more than we would require of them. Why have they done that? In my opinion it is because the issue of illegal and questionable payments is before the public and these firms believe that it's in their own interest, not necessarily because it's required by law, but it's in their own interest to disclose the payments. Obviously, if a payment is material it has to be disclosed under securities law. If it's not material, then it may be beneficial to disclose a payment so people realize that a company is not one of the "bad guys." It seems to me this accomplishes what we're trying to do. I personally believe quite strongly that we should avoid any unnecessary involvement of Government in business practices or in business enterprises. To the extent we can do what we think needs to be done without involving Government further, and encourage the private sector to correct the problems, which is what our approach tends to do, with our oversight; if we can do that, I think it will be the least costly way of attacking this problem and, frankly, I think disclosure on the basis of a flexible materiality concept is a much better way to have people meet a responsible standard as determined by the society around them than to require the disclosure of all payments of a specified amount by law.

The CHAIRMAN. Mr. Loomis?

Mr. LOOMIS. Mr. Chairman, there is not a great deal that I can add

to what my colleagues have said. We have approached this matter from the viewpoint of the administration of the securities laws and to obtain disclosure of information which is material. Materiality here is more than usually difficult because it is involved with questions of illegal or unethical conduct. Consequently, as you point out, we can't and shouldn't lay down for our purposes a simple standard that every payment over $1,000 or over $100 or any payment to a person who works for the Government per se must be disclosed. Rather, you have to look for these purposes at the facts of each individual case and determine upon the basis of all of the factors, and particularly whether there is a pattern of doing this as distinct from some employee going off on a sideline, or whether they are falsifying the books and records—those have been crucial factors in our determinations in this matter.

As to the question of whether there should be a statute that requires the disclosure of every payment over $1,000 to, for example, a commission agent employed to obtain business from a foreign government, we couldn't see a per se rule of that kind, an automatic rule as being useful under and for the purposes of the Federal securities laws, and we wouldn't like a situation where $1,000 was required disclosure but $999 wasn't.

Again, under the securities laws, this is not a kind of approach that's practicable.

The CHAIRMAN. Mr. Loomis, you're making a pitch it seems to me for a vagueness which I would think that the corporations wouldn't like. I would think they would want the certainty. They want to know what they have to report and what they don't have to report. They don't want to guess and find themselves in deep trouble because they guess wrong. If you require them to make reports for all payments over $1,000, at least they know that those have to be made.

Mr. LOOMIS. Yes, it would be more convenient for them I suppose.

Mr. CHAIRMAN. It would be clear to us. Then we'd know that all the reports are being made.

Mr. LOOMIS. If the Congress wishes this information for its purposes, certainly that is proper; but I don't think that this is an appropriate standard under the securities laws. Much of this information would be immaterial to investors. Something left out might be conceivably material, but that is the way it works.

Now I would just add one thing. As I say, we have worked on this from the viewpoint of the Federal securities laws. Whether or not the U.S. Government should get ito the area of attempting to outlaw this conduct by Federal law is a matter, as my colleagues have said, of national policy and with foreign relations implications. The State Department has indicated that an effort by the United States to extend its regulation into foreign countries, to lay down laws as to conduct there, might create problems. Whether it does or not I'm not qualified to say.

So that for our purposes, we didn't venture, as Mr. Pollack said, to advise you in the broad areas of foreign policy because we are not competent to do so.

For our purposes, I think that our program has been very successful and I think that it is undesirable to indicate the contrary. It has I think reached the essential problem that confronted us, if we're

72-525 O - 76 - 3

going to largely stop the type of payments which the chairman pointed out create a real problem while not getting into details. Whether a more comprehensive and automatic program is necessary I would think might wait a little further analysis as to whether ours has worked. I think it has.

The CHAIRMAN. Would you all agree that the payments of well over a million dollars to—the commission payments to Mr. Kashoggi and Mr. Kodama, that those should be disclosed in full?

Mr. HILLS. Mr. Chairman, the payments alleged in that context—and we have to say alleged because they are part of consent decrees entered into without admitting or denying the allegations in our complaint—not only were material because of the amount of money involved but also because were made without any corporate authority whatsoever, without any veneer of corporate authority. Moreover, the payments were not properly recorded in the corporate books and records and were made without the authority of the boards of directors.

The CHAIRMAN. Then you say that is material to investors?

Mr. HILLS. Material for any number of reasons, Mr. Chairman.

The CHAIRMAN. That's right. Well, then, where do you draw the line?

Mr. HILLS. It's important, I think, if I may with the chairman's permission, say with some pride in our staff that this report reviews the activities of the Commission and the responses of over 100 companies. Now I think the chairman and the committee is going to have to decide whether what we have caused to happen with respect to the problem we have found is a satisfactory resolution to that problem. I think Commissioner Pollack is correct in saying that when we find the problems, and with the help of the private sector we did find them, our staff, with the help and the cooperation of the private sector, performed admirably. I think the chairman should focus on this question. Looking at the 100-odd companies that have disclosed problems of this kind, ask yourself, what did the SEC leave in its wake? Have we, with respect to those companies, created a corporate behavior satisfactory to the Congress? Is that a satisfactory way to deal with problems we found?

Speaking both as a member of this Commission and as a citizen who is interested in the professional and corporate behavior, it seems to me that it is a satisfactory resolution to these problems.

What this experience has told us, Mr. Chairman, is something else. It has said that our present system does not bring these cases to our attention as we thought it would. We, therefore, want new measures to bring the remainder of the cases to our attention. We may find many more. There may be companies presently eluding us. I have enough confidence in our Division of Enforcement to think that we have the measure of the problem, but I cannot be entirely certain of that.

The CHAIRMAN. I want to get into that. First, let me ask you, would you support a flat legislative requirement that any payment which is illegal under foreign law must be disclosed?

Mr. HILLS. Mr. Chairman, I would not because I do not think we have the capacity to decide what is or is not legal under foreign laws. I hate to say how many file cabinets of my former law firm were filled with opinions expressing no opinion as to whether a given transaction was legal or illegal.

The CHAIRMAN. Then if there's doubt, why not report it? If there's doubt that it may be illegal, I would think that would be relatively simple.

Mr. HILLS. I have always hoped that it would be relatively simple, but it has never proven to be so. I have to say again that we have a system—and I hope the chairman believes me—that has been well enforced by the SEC. It has worked remarkably well by any standard. It is the finest enforcement mechanism for business practices. I think it is terribly important that we don't so distort the system by putting burdens on the capacity of this Commission and its staff that we lose sight of what we must do, namely, maintain the integrity of the corporate books and records.

I think that we have such faith and regard for the present system that we are anxious to avoid distorting the main thrust of our activities to do something else that has not been perceived to be necessary. Again, I come back to the point, we have, after all, under existing law discovered something that the rest of the world didn't think existed. We discovered it and we dealt with it. The enforcement actions that have been brought under the able leadership of Mr. Sporkin, the head of the Division of Enforcement, and the rest of our staff, have been remarkably successful in correcting instances of corporate abuse. Major corporate leaders have been deposed. Companies have been restructured. We have changed the governance of many of these companies.

Now if the change that we have caused to happen is sufficient, we are reluctant to do more than necessary to make sure that the other corporations are subjected to the same kind of scrutiny. If our present activities suffice, we have maintained the integrity and capacity of our Commission. We have not distorted our mission. We have not taken the chance that we will lose sight of our main role. We have to concede, as each of us have, that there may be some overriding purpose that we may not have recognized—foreign policy or some other concern. But I think we are so concerned about our capacity to perform our own job that has been performed so well that we would like to propose a measured response that gives us the capacity to assure that all corporations will be subjected to the scrutiny that the companies whose activities we have reviewed have so far been subjected to. That's why we say with some assurance that what we have proposed can do the job.

That's why you see such concern on our part that to do more, or to make us reach out to other things, can very well impair our capacity to deal with our present areas of important responsibility.

The CHAIRMAN. Let me come back to that question. Why do you not support a flat prohibition against any payment which is illegal in the country in which it's made, if it breaks the law in a foreign country? Why wouldn't it just be good citizenship, good cooperation among nations?

Mr. HILLS. We don't have the skill to say should we, can we, enforce the laws of the rest of the world? I'm sure the West Digest that reports these decisions would be full of cases trying to decide whether a given payment is or is not legal. The legal profession has enough business without going to all the countries of the world to try to establish whether a given transaction is right or wrong. We are concerned with the materiality of these practices. We are concerned that companies that make an illegal action know they are acting at their peril. If they

are discovered to have made illegal payments, and if, they don't have an overriding corporate purpose for having done so, the directors of that company are definitely at peril and are subject to enough pressure to assure that that won't often happen.

The CHAIRMAN. It just seems to me—Secretary Ball testified before this committee and he agreed wholeheartedly with the bill that we have introduced and he agreed that it was just wrong for a corporation to pay bribes. We ought to outlaw it and be done with it. Certainly we should outlaw, it seems to me, payments which are illegal under the laws of the foreign country. I recognize, of course, there's sometimes ambiguities and there's sometimes difficulties determining what is legal, but in most cases it's not that difficult and it just is unconscionable to me that we should permit bribery or the payments that are not legal in the country where those payments are made which are clearly illegal.

Mr. HILLS. Mr. Chairman, I can't say strongly enough, if I were a manager of a corporation, I would not willingly go into a country where I had to violate the law to do business. That's a matter of personal preference. From the standpoint of meeting the problem we have found, however, I must say to you that I see no reason to pass that kind of law to correct the problem that we have found.

I think that's the extent to which we can deal with the problem and advise this committee. What have we found? How can we deal with the problem we have found?

The CHAIRMAN. Now your report on page 43 to the committee refers to the Commission's limited resources. Exhibit A of your report seems to indicate that many of the voluntary disclosures supplied by corporations fall short of your own standards of materiality discussed in the body of the report.

What do you propose to require in the way of additional information? Will you independently investigate companies that filed incomplete voluntary reports?

Mr. HILLS. I must say that I believe we have the capacity to take the action against individual companies where we do not think they have given us adequate information. I obviously would not like to say to the committee which companies our Division of Enforcement is investigating, but Mr. Sporkin has assured us that while we are strained and, believe me, as we draw near to the end of this particular year we are in a severe budgetary strain, we can with our resources police the system as we should.

Let me deal with something more specific. You say generally what more will we require? We have many companies that come to us in the voluntary program whose disclosures give us reason, just as a matter of good administration, to say that we will inquire more fully into one area or another. I think I testified earlier that where we have an industry where some companies have admitted to making bribes for certain purposes in certain countries and we know that other companies in that industry compete in those same countries, we would be derelict in our duty if we didn't occasionally test those other companies to see whether they have been candid with us in asserting that they did not engage in similar practices.

I think it is that kind of intelligent, somewhat selective but persistent enforcement program through which we can make sure that we keep the system functioning properly.

I think that another important factor is that we do not accept the notion that corporate management has the authority to make any kind of illegal payment without exposing that matter to its governing body, to the directors, particularly the outside directors, and making it known to their auditors. We will persist in asking the auditors for assistance. We will persist in seeking help from the New York Stock Exchange and placing the responsibiilty on those segments of corporate management and the professional community that we expect to deal with them. As I said earlier, the exposure draft the accounting profession is now considering will automatically surface these problems to a level of management that can deal with them. By putting that responsibility on those managers, as we have through our enforcement actions and our voluntary disclosure program, our experience to date says that, by and large, we will put an end to them.

The CHAIRMAN. Well, you're saying that the illegal payments that are made should be reported to the Commission, but they should not be prohibited necessarily?

Mr. HILLS. Yes, I think that's essentially what we are saying. Our basic responsibility is to promote full and honest disclosure. Other agencies enforce other laws of the United States.

The CHAIRMAN. I take it you're looking at it from the standpoint of the SEC, not from the standpoint of the Congress.

Mr. HILLS. From the standpoint of our appearance here today, that is the limit of our expertise.

The CHAIRMAN. Therefore, you wouldn't have any particular objection if Congress wished to pass legislation making it illegal to make a foreign payment that was illegal in the country in which it was made?

Mr. HILLS. I would have to say, Mr. Chairman, speaking because of our role in corporate affairs, that to try to impose on any governmental agency in this country, whether it's the Justice Department or the Internal Revenue Service or the SEC, the job of trying to interpet all foreign laws and ferret out all the law enforcement problems of the world would put a burden almost beyond capacity of our Government to meet

The CHAIRMAN. Of course you wouldn't do that. I wouldn't expect you to do that and that couldn't be done. You don't have the staff to do it and you couldn't begin to do it. But it would be the basis for action against a company if you found in the course of your investigation that they had made payments that were illegal in the foreign country and then that would be a clear violation of the law. I wouldn't expect you to go out and audit the books of all the thousands of corporations that have business abroad in order to do that.

Mr. HILLS. Mr. Chairman, if I could confuse our problem further, we should not necessarily focus on illegal conduct alone. We use the word "questionable" in almost every case. The point is, if a company is doing something——

The CHAIRMAN. Let me just interrupt. What I'm trying to do is make this as specific and definite as I can and as clear, so the Congress understands what it is and the public understands what the law is and the corporations that are being regulated understand the law, and when you're operating in this kind of misty land of questionable payment or materiality, it makes it much more difficult for everybody concerned.

Now it may be from your standpoint and the standpoint of the SEC desirable that you do that, and I can see that it has its advantages. After all, if you have a wise corporate head, he just won't take any chances and he will go much further than maybe even you or I intended him to go, and maybe that's a good thing. I'm saying it from the standpoint of treating everybody the same, from the standpoint of getting rigorous effective enforcement of the law, it seems to me it's better to have it specific and definite and clear.

Mr. HILLS. Mr. Chairman, we are all sobered by our experiences in recent years. There presently is an argument between the accounting and legal professions as to how best to interpret conduct which may not be clearly illegal but which may nonetheless threaten to raise material problems for the corporation. The confusion and antagonism you have perceived between those two professions each trying its best to find out how to articulate this kind of issue with respect to domestic laws and disclose the kinds of United States legal actions or lawsuits that might be pending against certain corporations, perhaps afford some notion of the complicated issues that might arise in any attempt to incorporate foreign laws.

The CHAIRMAN. Would you support a provision giving the Commission the right of access to books and records of a publicly held corporation without first opening a formal investigation, similar to the right of access you now have with respect to broker-dealers?

Mr. HILLS. The Commission's position on this point is that we have sufficient access for our purposes. We have, on occasion, been burdened somewhat by protective orders that are sought by corporations for the purpose of protecting themselves against things like the Freedom of Information Act inquiries. To date, however, we have had sufficient access for our purposes.

The CHAIRMAN. Would you oppose that kind of provision in the law giving you access to the books and records of publicly held corporations?

Mr. HILLS. Mr. Chairman, at this stage, I would oppose that provision because it would give us an authority and a power beyond the problems that we have discovered, and I think that it would cause more problems for our own activities than we presently need to invite. We have the kind of capacity where we are called upon to exercise responsibilities in the nature of economic regulation, such as the more detailed regulation of broker-dealers. We don't see the need for this provision in the broader context, however, and my personal view is that we should not seek laws that we do not need.

The CHAIRMAN. Now on page 13 of your report to the committee you note that in nearly every case of improper corporate payments there was some falsification of records, some evasion of the system of corporate accountability. You say further, that apart from the question of materiality, the existence of inaccurate records per se provided an independent basis for requiring some form of disclosure or the initiation of Commission enforcement action.

In other words, the Commission could go after these companies because they kept false records?

Mr. HILLS. That is correct.

The Chairman. Now it's always been my impression that you have that power under existing law and I wonder what you gain by your

proposed legislation that would spell out more explicitly perhaps that a corporation has an obligation to keep it on its records.

Mr. HILLS. Yes. While it is true that we have and have exercised authority to deal with the problem of companies that have maintained false books and records, there is no explicit requirement under the Federal securities laws dealing with that problem or, more to the point, requiring that corporations establish and maintain adequate systems of internal controls. Given the nature of the problem and the past practices we have discovered, we have determined to seek a specific statutory requirement rather than leave open to question whether we could achieve this goal indirectly through exercise of our rulemaking authority. We think it is important that the requirement in this area be established quickly and in a manner that minimizes the possibility of misunderstanding. I should emphasize, moreover, that our proposals represent a combination of factors. First, we seek an explicit statutory requirement that, for instance, requires that transactions be adequately identified and, second, makes clear that misleading information or false statements to auditors would provide the basis for civil and criminal liability. To supplement those requirements, we will exercise our rulemaking authority to impose on auditors the responsibility of reporting on the adequacy of those controls.

I admit that it makes for dull reading, but these proposals will provide the teeth to assure that problems of this nature are brought to appropriate levels of corporate management and recorded in a manner that makes it far easier for us to discover them.

The CHAIRMAN. Now if we pass that legislation, let's say it makes it a bit more clear that the company must keep on its records, but we don't require disclosure per se of all foreign bribes. Aren't we just spending a great deal of effort to put a finer point on a requirement that already exists while ignoring the more obvious need for new authority? You see, the lengthy discussion in your report on materiality begins to sound like angels on the head of a pin. Obviously, we all want disclosure of improper overseas payments. That is the thrust of the report. But why do we do it by stretching the materiality doctrine almost to the breaking point? Why not just require it directly?

Mr. HILLS. Because, Mr. Chairman, our basic responsibility is to assure the disclosure of material facts to investors and shareholders. Strengthening the system of internal corporate accountability will promote that goal and will, we think, largely put an end to this problem. This new legislation will give us greater confidence that we will find these problems without some of the difficulties and delays we have had in the past. As we have found these problems, we have dealt with them. Equally important, our activities also have been designed to require responsible members of corporate management to deal with these problems. This legislation will not only assure that we find the problems, but will effectively impose a responsibility on the boards of directors to deal with them. We think that will stop the problems this committee sees.

The CHAIRMAN. Well, suppose we were to approve legislation that gave you the new recordkeeping provision you requested and also required disclosure of all foreign bribes as defined in S. 3133, and suppose the committee dropped the provision flatly prohibiting foreign bribes. Would you support that?

Mr. HILLS. Mr. Chairman, as I said earlier, I personally cannot support a major incursion of this kind where we do not think it is called for by the problem we have found. It would cause us to look at the corporate books and records with a distorted perspective. We presently have a perspective on disclosure that is keyed to the concept of materiality. Our staff deals with it, and its recognized ambiguities, as do our auditors and lawyers. This is the basis for a procedure and process which has, as I said earlier, maintained the integrity of the American business and of the securities markets to a far greater degree than any other system in the world. Thus, to place this substantial emphasis on something that is not required by to the problem we have found imposes a burden on the Commission and may well put a potential burden on the disclosure documents, in the final analysis, may obfuscate a matter of greater importance to the overriding problem of this Commission; namely, the maintenance of fairly presented, accurate, and adequate displayed corporate information.

And so to yield to that in one area will obscure the problems in all the other areas that we are responsible for.

The CHAIRMAN. The analysis of disclosures received by the SEC indicates many of them are minimal. Page 40 of your report to the committee contains a remarkable admission. You say. "Some of the filings we have analyzed are not sufficiently clear to support a firm determination that the payments or practices were foreign or domestic."

How can you accept a filing which fails even to provide basic information such as whether it's foreign or domestic? In those cases, did you request additional data? Doesn't this indicate that we need a clear statutory definition of what must be disclosed?

Mr. HILLS. Well, Mr. Chairman, keep in mind that in disclosures we have summarized for the committee are those of companies that have come forward and stated what they believed to be material and to identified other payments that neither they nor we may regard as material. In many cases it is not at all clear that some of the payments that have been identified are illegal. As we have said earlier, some companies have made revelations of very small payments, some in the hundreds of dollars, that are obviously legal in the country where they were made. Moreover, many companies have made disclosures of matters of this kind without consulting with the Commission in advance.

Companies participating in the voluntary program come to us to disclose what has happened. They can get the informal views of the staff, and in some cases the Commission itself, regarding what should be disclosed and the manner in which disclosure should be made. If we have reason to believe that the matters companies disclose to us in the voluntary program reveal the possibility of deeper problems, our Division of Enforcement will avail itself of the promised access to the corporations' books and records and investigative materials and engage in a more in-depth inquiry. Similarly, we have and will examine more carefully the activities of other companies, not in the voluntary program, that have made some disclosure of matters of this kind whenever we determine that the circumstances call for that.

The CHAIRMAN. Now our bill, S. 3133——

Mr. HILLS. Excuse me, Mr. Chairman. I might add, as Commissioner Evans has reminded me, often they will disclose matters that are immaterial to us and we have no reason to inquire further. Excuse me.

The CHAIRMAN. S. 3133 would require the disclosure of payments and commissions to foreign sales agents, as well as disclosure of outright bribes. Your report takes the position that under existing law, disclosure of agent payments might be required, depending on their size, purpose, form of payment, and relationship between the agent and foreign government. Certainly, under any test, large payments to a Kodama or a Kashoggi are material information, regardless of how much ultimately flows to the pockets of foreign officials.

At the same time, bona fide sales commission payments may sometimes be proprietary information. If we pass a disclosure bill, shouldn't we also include disclosure of payments to nongovernment foreign agents?

Mr. HILLS. Mr. Chairman, requiring disclosure of ordinary business payments when we have no reason to believe they are improper or made for improper purposes would only further compound the principal responsibility we have—requiring the presentation of material information. The payment of legitimate sales commissions to non-government officials where there's no reason to believe that the money is going for an improper purpose is——

The CHAIRMAN. How do you determine that?

Mr. HILLS. Well, I think that your earlier comment about Justice Stewart may be relied upon for this purpose. Some companies complain, how are they to distinguish between a proper foreign commission and a questionable one? So far, in the cases in which we have brought enforcement actions, the man who made the payment had no doubt why he was making it. There are in some cases difficult matters of proof. I can't say we can prove every case, but I don't see the problems of proof are any greater in this area than in so many other areas. Companies obviously proceed at their own peril. If they had reason to believe there a questionable payment was made and they choose to ignore the obvious, they may violate our laws through nondisclosure of material facts.

Our approach, and the thrust of our proposals, is to say to American businessmen, you do not have the right to close your eyes when you drop off a large payment. If you don't know why you're making that large payment, you're at risk as to its purpose and the problems that may arise from its nondisclosure.

The CHAIRMAN. Now in your comments on the bill, S. 3133, you express concern that there might be some circumstances in which public disclosure of the ultimate recipient of a foreign payment might serve no positive goal. You may have noted that S. 3379 treats that question by providing on page 9 of the bill that the information reported to the SEC under the disclosure provision shall be made publicly available unless the President of the United States determines that such disclosure would severely impair the conduct of U.S. foreign policy.

I could conceive of other possible tests, and the SEC, rather than the President might be empowered to determine when information should be kept confidential. If the presumption is in favor of public disclosure, I agree it is not unreasonable to provide for the exceptional case when the information should go only to the SEC.

Would a provision along those lines solve your problem? Would you work with the committee to devise language?

72-525 O - 76 - 4

Mr. HILLS. Well, Mr. Chairman, I think that our problem, again as we perceive it, is solved by the legislation we are proposing. Again, I think we have to ask ourselves, looking at the cases that we have seen, would some public purpose be served by having required a greater degree of disclosure than we did require? There may well be a public purpose, a legislative purpose, beyond the purposes served by the Federal securities laws. It would be wrong for me to try to express an authoritative view as to those matters.

But with respect to our guiding mission, I don't see that we need legislation forcing more disclosure than we have required. Again, I might say that traditionally we have been quite cooperative with foreign governments that are anxious to enforce their laws. Similarly, we have cooperated in these current problems and have provided information for transmission to foreign governments which have come to our Justice Department to ask for it. In some cases, the identity of a given person in a foreign country may not be in our files and may be beyond our capacity to establish. In fact, many companies themselves claim that they cannot establish or verify these facts in some cases. That does not excuse them from making the payments, however, and we have required them to take remedial action in appropriate cases. This makes it difficult for us to be confident that all of the information we have is accurate and, as I said earlier, I think you have to judge whether the disclosures we have required is adequate for the legislative purposes of this Congress.

The CHAIRMAN. Now, have you had a chance to study the bill introduced by Senator Church and others?

Mr. HILLS. Senator, I apologize, we have not. We will file, I'm sure, within a matter of days, an analysis of that bill. The only comment that I would make—and this must be a personal comment because the four of us have not studied the bill and discussed it thoroughly among ourselves—is that it would change rather dramatically the relationship that now exists. It would impose on the Commission far more of the role of being a direct governing body, setting accounting standards, setting accounting principles. Thus, it would dramatically change the role the Commission now serves in relation to private industry. And again, it seems to me—and I believe it will eventually seem to us as a commission—that that kind of dramatic change is not needed to meet the problems we have uncovered.

The CHAIRMAN. Let me ask you about a particular section of the bill. Section 8 provides for an audit committee composed of a corporation's independent outside directors who must comprise at least one-third of the corporation's board. Would you think that would be helpful?

Mr. HILLS. Mr. Chairman, I have the greatest of optimism that the New York Stock Exchange and others will respond to our request that they consider creating independent audit committees. I personally think any company of significant size should have an independent audit committee. My personal view also is that larger companies should have a majority of outside directors. It's quite discouraging to be an outside director in a minority position. One wonders why they come to the meeting if the management decision is always going to be the governing decision. Finally, I believe that lawyers would have their independence bolstered if they did not sit on the boards of clients for whom they give advice regarding the securities laws.

We only recently made this suggestion, and it was well received. I think we will await a responsible response from the self-regulatory organizations. There are a number of problems, of course, establishment of independent audit committees does not end the matter. Questions exist as to what they should do. It would, appear, for example, that these committees should have private meetings with the outside auditors to discuss the scope of the audit. Nothing else will work well unless the outside audit committee understands the scope of the audit. There should be an additional meeting before the report is published to see whether there are problems that management has glossed over. Proper effectuation of this concept requires dealing with any number of problems regarding access to information. These are things I am confident can be worked out. Moreover, it is conceivable that under the authority we now have, we could arrange for the creation of some form of independent audit committee in the event we fail to get the cooperation we consider necessary.

My own hope is that the private community will respond and we will not have to push existing law that far. There is reason for optimism, for something like 85 percent of the larger publicly traded companies have some form of an independent audit committee, although they do not all work under the same rules and the processes have not been institutionalized.

The CHAIRMAN. Does the same percentage hold—at least a third of their outside directors? Is there any study of that?

Mr. HILLS. I believe so, Mr. Chairman. I can provide you the studies that we have. We're asking for more help. I might say personally that some 6 years ago I accidentally became chairman of a company. At that time the outside audit committee was rare, but we created an independent audit committee at once. Moreover, we had all outside directors except for the chief executive officers.

The CHAIRMAN. It seems to me that this isn't in my bill so I can be a little more objective in criticizing it. It would seem that passing a law to require that a corporation have to have a certain proportion of outside directors is something we should consider with considerable care and time and with a record before us so we know what we are doing, and I think that might be objectionable at least to move right ahead with that.

On the other hand, an audit committee to do this—this is the kind of very constructive action the SEC has been pressing for and pushing and you had it in some cases—it seems to me it would be the kind of action you might be able to get somehow without passing legislation that mandates corporations having their directors appointed from outside management.

Mr. HILLS. I quite agree, Mr. Chairman.

The CHAIRMAN. Perhaps we could work on that and work up some kind of compromise.

Mr. HILLS. We will continue to report to the committee on progress we make in the private sector.

The CHAIRMAN. Now would you favor section 9 of the bill which creates a shareholders right of action in the case of any shareholder who can demonstrate actual damage or waste of corporate assets in connection with overseas payoffs or failures to comply with the disclosure law?

Mr. HILLS. Mr. Chairman, I'd like to hide under the cloak of time for consultation with our General Counsel and the other Commissioners. I think we need to evaluate that proposition in light of the existing status of independent shareholders rights, and I would rather not speak hastily on the subject. We will speak thoughtfully on this subject this week.

The CHAIRMAN. Now in an article that appeared Sunday in the New York Times, there was the assertion by an official in the Department of Justice that if payoffs were made abroad in order to get business away from another American competitor there was a clear violation of the antitrust laws. I don't know about that, but section 10 of this bill that I'm talking about, the Church bill, provides right of action by any person that can show that its business is placed at a competitive disadvantage by a competitor who made illegal payments. Would you support that?

Mr. HILLS. Again, I am not sure that it's needed. I must say, as a former trial lawyer, it always seemed to me that a company that competes unfairly for business abroad has committed some actionable misconduct. "Interference with advantageous corporate relationships" and "unfair competition" are traditional concepts that frequently lead to corporate litigation. Additionally, I will say that American business has more tools to deal with improper foreign competition than they may think, or at least than they have exercised.

The CHAIRMAN. That's the key point. They are not exercising it. What can we do to see that they exercise it? Some of these payments—one corporation made very heavy payments abroad and it was competing primarily, to my knowledge, against American competitors. No question about it.

Mr. HILLS. I have made that point several times.

The CHAIRMAN. But the American competitors didn't do anything about it, didn't take any action.

Mr. HILLS. As I have previously stated, I believe and hope and trust that many of the things we're discussing now would be part of the thrust of the proposals of the White House task force. I have also said that agencies, such as the Federal Trade Commission and other Federal agencies of Government, should consider how to devise solutions to this problem. I know Chairman Collier is considering the reach of FTC jurisdiction he has in this area. I expect that there will be litigation on some of these matters, and that the rights of American business will be considered.

I should point out to the chairman a number of large foreign companies seek access to our capital markets and list their securities on our exchanges. They will be subject to our rule. I don't think the American business has yet done enough. Whether they are competing with American or foreign companies engaging in questionable practices, I think we have sufficient economic authority in this country to deal with the problem.

The CHAIRMAN. On page 33 of the report you say that under the SEC's so-called voluntary program you have not generally required disclosure of the identities of recipients. Why not?

Mr. HILLS. Well, I must raise again the simple point, Mr. Chairman, that our job is to require the disclosure of material facts. Again,

I must ask the committee to look at the cases we have brought and the disclosures we have required and thereafter make a balanced judgment whether the action we have taken is sufficient.

The CHAIRMAN. One purpose of requiring disclosure of unsavory practices is to deter them, and isn't the deterrent effect more powerful if the people involved are disclosed? If they know they are going to be disclosed, it seems to me that's one of the most powerful ways to deter this kind of activity.

Mr. HILLS. I'm sure of that. I'm sure the chairman, appreciates, however, that our primary function is to require a fair presentation of material facts. Tempting as it may sometimes be, our primary function is not to try to cause changes in behavior. We recognize, of course, that we may change behavior through disclosure but our job is primarily to cause a fair presentation of material facts.

The CHAIRMAN. Why shouldn't it also be a cause to change behavior so it will stop illegal payments?

Mr. HILLS. We are a specific agency with specific responsibilities. We don't sue people who bribe local officials unless they have violated the Federal securities laws. If Federal officials are bribed, if antitrust laws are violated in this country, the prosecutorial responsibilities rest elsewhere.

The CHAIRMAN. I understood you in your opening statement to indicate great satisfaction that you have changed behavior.

Mr. HILLS. We have immense satisfaction in the fact that the disclosures we have required have, in all but a small number of cases, caused a change in corporate behavior. I think we can take immense satisfaction that American business, having been forced to face up to these kinds of problems, has determined to stop these payments. I think that that shows the wisdom of our disclosure policy; it is a better alternative than direct regulation.

The CHAIRMAN. One of the outstanding examples of that is in the *Gulf* case where names were disclosed in great detail and it seems to me that was a highly satisfactory and effective kind of action. That's why I repeat, why not disclose the names of the recipients? Why not make it known? This is something the Japanese Government, in the *Lockheed* case for example, has been pleading with us for—the Diet, both branches, passed legislation calling on us to disclose it—the premier—they all asked for it and yet we refuse to disclose the names.

Mr. HILLS. Mr. Chairman, I think from the perspective of your question, the disclosures we have required have, in all but those four cases which we have isolated for the report, caused the change in behavior you seek. Accordingly, we have not needed more disclosure. More disclosure would not have changed anything because the disclosures we did cause, except in the four cases, has caused the desired change.

The CHAIRMAN. Except in the four cases. The four cases represent instances where some people would say they showed an unusual degree of honesty. They said we are going to keep right on bribing, in effect. The others didn't say that and you wouldn't expect people to say that, even if that might be perhaps their intention. We don't know what effect these policies of yours are going to have. We hope they will have a deterrent effect. We know, however, if you disclose the names of the people involved here, that's going to be a very effective deterrent.

Mr. HILLS. Mr. Chairman, if a company states that it will stop a practice and thereafter does not, in my judgment, continuation clearly is a material fact that must be disclosed. If the company declared to the stockholders that it would stop a practice and thereafter did not, I think there is no question that this would be a factor related to the quality of management that should be disclosed. The bill we propose will help us discover those things if they do occur.

The CHAIRMAN. In the *Lockheed* case, paragraph 9 of the final judgment of permanent injunction against Lockheed, gives the Commission the right to apply to the court for additional information if you are not satisfied with the investigation conducted by Lockheed's special committee of the board. I believe you had a similar provision in 12 other cases. Have you ever taken advantage of this provision? For example, in the *Gulf case* or any other similar case, did you feel the need to ask for any information beyond that provided by the company's own report?

Mr. HILLS. Mr. Chairman, I'm reluctant to comment on the extent to which we may or may not be pursuing additional enforcement activities. I think I can say on behalf of the entire Commission we are quite pleased with the Gulf report. It was an excellent job, done by a superb chairman and committee. I might add that in the Lockheed case we have reserved the right to continue our investigation while Lockheed is conducting its investigation and preparing its report, and we have no reluctance at all to do so in that and other cases if we think that is necessary.

The CHAIRMAN. Well, these 12 cases, have you followed up in any of those? In each of those cases you indicated you could get more information. Have you tried to do so?

Mr. HILLS. Mr. Chairman, I have to defer to Mr. Sporkin who is in the audience. Again, I must say I am reluctant to discuss this in detail or indicate publicly whether we had an enforcement action continuing against any of these companies. We would be delighted to have the committee staff discuss our practices with respect to each of these companies with Mr. Sporkin in private.

The CHAIRMAN. Let me ask Mr. Sporkin. Mr. Sporkin, will you stand? Could I ask you again, any of these 12 cases involved here, the Commission used the right to apply to the court for additional information because it was not satisfied with the investigation conducted by the special committee?

Mr. SPORKIN. There was one instance, sir.

The CHAIRMAN. One instance?

Mr. SPORKIN. The company initially filed a report and excluded two very critical pages listing the recipients of the money. With the Commission's authorization, we wrote a letter indicating that we were dissatisfied, and I think we indicated that we would go to court for relief. By writing that letter we obtained those two pages and they were publicly disclosed. That was the *Ashland* case.

Mr. HILLS. To make certain that is clear, the letter was sent to the company indicating that we would seek judicial relief if they did not publicly disclose those facts.

Mr. SPORKIN. That is correct.

Mr. HILLS. I'm sorry, Mr. Chairman. I did not have a focus on your question. We also have the right to continue our investigations without seeking judicial relief.

The CHAIRMAN. But you have not actually gone to court. In this case, you wrote a letter that Mr. Sporkin referred to.

Mr. HILLS. To the company's management.

The CHAIRMAN. In all of the other cases you are satisfied with the company's investigation of itself?

Mr. HILLS. I personally have no reason to question the sufficiency of the investigations conducted by these independent committees.

Again, it is always possible that our Division of Enforcement has something that they think they should pursue further. But to date we are quite satisfied, I must say I think we are universally satisfied, with the quality of reports we have secured from these independent committees.

The CHAIRMAN. Now I am troubled by that. Would you have the staff resources to spot check at least in some of these cases? It seems to me if you establish a procedure in which you almost never, practically never go to court to get additional information, that that becomes known in the industry, and they would be less likely to be as comprehensive as they would or should be.

Mr. HILLS. Mr. Chairman, let me try to restate the point I tried to make earlier.

We do not have to go to court to spot check these companies. We can do this without seeking judicial authorization. And we will, and I have said this publicly——

The CHAIRMAN. Have you, as a matter of fact?

Mr. HILLS. Have we made investigations of some companies within our jurisdiction?

The CHAIRMAN. Yes.

Mr. HILLS. Let me say again that these are all such recent cases, I would prefer not to say whether we have a pending enforcement actions in them. But I don't think anybody in a major American business has any doubt that we will check them.

The CHAIRMAN. Do you have the resources, the staff to do it?

Mr. HILLS. We do indeed, and we intend to do it, sir.

The CHAIRMAN. In both the domestic and foreign bribery area, despite the SEC's excellent work, there seems to be a hesitancy to go after white collar crime with quite the same vehemence this society goes after violent crime.

Nobody has gone to jail for domestic corporate bribery. Only three companies have fired top officials. And Mr. Haughton and Mr. Kotchian are still on Lockheed's consultant payroll for close to $100,000 a year each.

No corporate official has gone to jail for violation of the securities laws by phonying up books in order to disguise foreign bribes.

In both cases, the SEC and the special prosecutor have said, in effect, "Come forward, admit your sins, and you will be treated gently."

That is fine up to a point, but doesn't it become self-defeating? Shouldn't you be a bit tougher on them? Will you be if you get new authority?

Mr. HILLS. Mr. Chairman, we have done nothing in our voluntary disclosure program or our enforcement actions that promised or suggested for one moment that officers of corporations engaged in the kind of conduct we have been discussing, the more outrageous cases,

should not be subject to criminal prosecution. Moreover, we have referred and will refer cases in this area to the Department of Justice for possible prosecution.

I share your concern that the white collar crimes in this country are not being prosecuted with sufficient vigor, and that the sense of justice in the country suffers when people who engage in some of these practices are not incarcerated as readily as are people who engage in other kinds of crime.

One of the reasons we have proposed our legislation proscribing the falsification of corporation records and prohibiting certain omissions and false statements to auditors is in order to provide a better basis for prosecution.

I think the chairman should keep in mind that the cases we have referred to the Justice Department are relatively recent cases. There have been indictments in at least one case, and the notion that these people can engage in these practices without threat of criminal prosecution is one that I hope that we can dispel.

The CHAIRMAN. I hope we can, too. It is going to take some doing to do so.

The Gulf investigation took some 30 lawyers and accountants nearly a year to conduct. That is probably more lawyers than your Enforcement Division can spare for the entire voluntary disclosure program.

Do you have enough staff to really dig into this? How many do you have?

Mr. HILLS. Mr. Chairman, we presently have approximately 140 professional staff members in our Division of Enforcement, as well as some 50 additional support personnel. We also have the resources of the Office of the Chief Accountant and the Division of Corporation Finance, as well as members of the General Counsel's Office and of our regional offices.

I must say, however, that we would not have the staff to approach doing an adequate job if we were unable to secure the kind of judicial relief by consent that the Division of Enforcement has obtained and also to encourage the further assistance and cooperation of the private sector in our voluntary disclosure program.

It is the capacity of the private sector to provide the people to assist in this entire endeavor that is the very basis for our capacity to administer this part of the securities laws.

I must say again that this is the reason why we are asking for the kind of response we seek to the problem we have found.

The CHAIRMAN. How many staff people do you have working full time on this project?

Mr. HILLS. I am afraid we would have to give you a guess. At a given time, a given meeting, we may have 30 people in the room on a given problem, all discussing nothing but that subject in a given case.

The CHAIRMAN. Well, full time, not discussing it in a room at one time, but full-time investigators working on this?

How many man-years, put it that way?

Mr. HILLS. Mr. Chairman, I would prefer to give you a specific answer to that question. A guess will not help the committee.

I think any of our guesses right now would be misleading. I will be happy to make a reasoned estimate and submit it to the committee.

The CHAIRMAN. Can Mr. Sporkin tell us that?

Mr. SPORKIN. In my own office we would be spending between 20 to 25 man-years.

The CHAIRMAN. Twenty to 25 man-years. And how many corporations are there?

Mr. HILLS. There are well over 9,000, Mr. Chairman, that report to us.

You can look at that from the standpoint of cost-benefit analysis and——

The CHAIRMAN. Yes; it is a terrific benefit-cost analysis, a place where we could invest a litle more with good returns.

Mr. HILLS. It is wrong, however, not to pay some tribute to the thousands of independent certified public accountants and outside counsel that are an integral part of the system.

The CHAIRMAN. I agree.

Do you intend to request additional staff for bribery investigations?

Mr. HILLS. Mr. Chairman, we have requested additional staff for fiscal year 1976. I should point out, however, that we have other responsibilities that the Congress has asked us to perform.

We have worked very hard on the budget during this past year to try to assure that we will have enough money to perform all our responsibilities. I have said publicly and I will say again here that it is very hard for us to get to July 1 this year.

I think at the present time we have enough staff for next year, but I have told the House Appropriations Committee, and will similarly inform the Senate that it is entirely possible that enforcement problems and problems of economic regulation will require us to seek even more staff allocations than we have requested to date.

We are taking some rather dramatic internal steps to make ourselves more efficient. We have a proposal to microfilm all of our records, and we think that will be a significant advance.

Whether our efficiencies can provide enough power to meet all of the problems we must confront, including the question of bribery, is a matter of conjecture.

The CHAIRMAN. There is a rollcall on, I don't want to keep you gentlemen beyond that rollcall, if possible.

I have some other questions I would like to ask. But let me ask one more question, and then see if any of the other Commissioners would like to make a statement.

Ralph Nader has concluded from an analysis of nearly 100 corporations which have made disclosures to the SEC that in every case where a civil suit by SEC forced the company to undertake a detailed special investigation it was found the initial voluntary disclosure by the firm omitted relevant details and understated amounts.

If that is accurate, why have you accepted the voluntary disclosure at face value in all of the other cases, and in only 13 cases have you sought special review committees?

Is that primarily a shortage of SEC staff to prepare cases?

Mr. HILLS. It is not a shortage of staff. None of the companies against which we have sought enforcement action were participants in our voluntary disclosure program. Moreover, I should point out that the voluntary program followed our initial enforcement actions in this area. The program only began after a significant number of cases

72-525 O - 76 - 5

were brought by our Division of Enforcement. Thus, Mr. Nader's analysis includes some voluntary disclosures that were made prior to the time in which the present climate of disclosure was fully developed. I might add, as I have indicated before, that we will vigorously examine some companies participating in our voluntary basis on a selective basis in order to assure that their disclosures are accurate and adequate and that the integrity of that program is maintained.

The kind of changes we are seeking are precisely related to putting some teeth into the voluntary disclosure program. In other words, if those voluntary disclosures are inappropriate, our criminal sanctions and enforcement sanctions will be all that more severe.

The CHAIRMAN. Now, would any of you gentlemen like to make any concluding remarks before I make a brief statement?

Mr. POLLACK. No, Mr. Chairman.

The CHAIRMAN. Mr. Evans?

Mr. EVANS. No, sir.

The CHAIRMAN. Mr. Loomis?

Mr. LOOMIS. No, thank you.

The CHAIRMAN. I would first like to commend the SEC and you, Mr. Hills, all of you Commissioners, for the job you have done.

As I say, you are the only agency in the Government that hasn't gone to sleep on this issue, and you have done, I think, a good job under the circumstances.

I have been asking these questions this morning because I am interested in getting effective forceful legislation that is going to stop these practices in the future. I think you have done a fine job of responding.

I think the principal differences between us, of course, are that from the SEC's standpoint, the notion of using materiality as the instrument may be satisfactory. From the congressional standpoint, I think the moral issue and the political issue may be far deeper than that, and may be far different.

I feel that we have to enact legislation that goes further than the SEC would view it from the standpoint of investor protection.

That doesn't mean it is inconsistent or contradicts your position; it is just we have a more comprehensive responsibility.

Mr. HILLS. We appreciate that distinction.

The CHAIRMAN. I want to thank you gentlemen very, very much. It has been a most useful morning. I think you have made a fine record. Thank you very much.

[Thereupon, at 11:40 a.m., the hearing was concluded.]

[Copies of the bills being considered at this hearing follow:]

[S. 3133, 94th Cong., 2d sess.]

A BILL To amend the Securities Exchange Act of 1934 to require issuers of securities registered pursuant to section 12 of such Act to maintain accurate records and to furnish reports relating to certain foreign payments, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 17 of the Securities Exchange Act of 1934 is amended by adding at the end thereof the following:

"(h) The Commission shall, by rule or regulation, require issuers of securities registered pursuant to section 12 to maintain accurate books, records, or accounts of all transactions in such form and containing such information as the Commis-

sion deems necessary to carry out its enforcement responsibilities under this title.".

SEC. 2. Section 13 of the Securities Exchange Act is amended by adding at the end thereof the following new subsection:

"(g) Each issuer of a security registered pursuant to section 12 shall file with the Commission periodic reports relating to any payment of money or furnishing of anything of value in an amount in excess of $1,000 paid or furnished or agreed to be paid or furnished by the issuer during the period covered by the report (i) to any person or entity employed by, affiliated with, or representing directly or indirectly, a foreign government or instrumentality thereof; (ii) to any foreign political party or candidate for foreign political office; or (iii) to any person retained to advise or represent the issuer in connection with obtaining or maintaining business with a foreign government or instrumentality thereof or with influencing the legislation or regulations of a foreign government. Such reports shall be made available for public inspection and copying and shall include such details as the Commission may prescribe including—

"(1) the amount of each such payment or thing of value and the date it was made or furnished or agreed to be made or furnished;

"(2) the name of the person or entity to which the payment was or is to be made or the thing of value was or is to be furnished and in the case of a person who is an official of a foreign government or instrumentality thereof, the official position of that person; and

"(3) the purpose for which the payment was or is to be made or the thing of value was or is to be furnished.".

SEC. 3. The Securities Exchange Act of 1934 is amended by inserting after section 30 the following new section:

"PAYMENTS TO OFFICIALS

"SEC. 30A. It shall be unlawful for any issuer of a security registered pursuant to section 12 to make use of the mails or of any means or instrumentality of interstate commerce to—

"(1) offer, pay, or agree to pay any money or offer, give, or promise to give anything of value to an individual who is an official of a foreign government or instrumentality thereof for the purpose of inducing that individual to use his influence within such foreign government or instrumentality to obtain or maintain business for or with the issuer or to influence legislation or regulations of that government;

"(2) pay or agree to pay any money or give or agree to give any thing of value to any person knowing or having reason to know that all or a portion of such moneys or thing of value will be offered, given or promised directly or indirectly to any individual who is an official of a foreign government or instrumentality thereof for the purpose of inducing that individual to use his influence within such foreign government or instrumentality to obtain or maintain business for or with the issuer or to influence legislation or regulations of that government;

"(3) pay or agree to pay any money or give or agree to give any thing of value to any foreign political party or official thereof or any candidate for foreign political office for the purpose of inducing that party, official, or candidate to use its or his influence with a foreign government or instrumentality thereof to obtain or maintain business for or with the issuer or to influence legislation or regulations of that government; or

"(4) pay or agree to pay any money or give or agree to give any thing of value in a manner or for a purpose which is illegal under the laws of a foreign government having jurisdiction over the transaction.".

SEC. 4. (a) The last sentence of section 21(d) of the Securities Exchange Act of 1934 is amended by inserting before the period at the end thereof a comma and the following: "or, notwithstanding any other provision of law, the Commission may initiate (through a presentation to a grand jury), prosecute, and appeal any criminal action arising under this title.".

(b) The second sentence of section 20(b) of the Securities Act of 1933 is amended by inserting before the period at the end thereof a comma and the following: "or, notwithstanding any other provision of law, the Commission may initiate (through a presentation to a grand jury), prosecute, and appeal any criminal action arising under this title.".

[S. 3379, 94th Cong., 2d sess.]

A BILL To require reporting and analysis of contributions, payments, and gifts made in the conduct of international business, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "International Contributions, Payments, and Gifts Disclosure Act".

FINDINGS AND PURPOSES

SEC. 2. (a) The Congress of the United States, after extensive examination of facts presented in public hearings, by the Securities and Exchange Commission and in public statements made by major United States companies and foreign governments, finds that certain United States based companies have made, and may continue to make contributions, payments, or gifts or convey other benefits upon foreign individuals, foreign governmental employees, foreign politicians, and foreign political entities, which may be illegal in the country where made or of a questionable nature and that when these payments are discovered and become publicly known they create substantial foreign policy problems for the United States. Specifically, these contributions, payments, and gifts can allow, and in some instances have allowed, corporate interests to take precedence over United States foreign policy objectives and can create and foster an anti-American sentiment in individual foreign countries.

(b) Therefore, it is the purpose of the Congress of the United States to insure availability of adequate information about such payments to the Department of State and the Congress of the United States. To this end, the Department of State is charged with providing Congress with a comprehensive review and analysis of such contributions, payments, and gifts and their foreign policy implications.

(c) The Congress of the United States also finds that certain contributions, payments, and gifts, which were made, and may continue to be made, have an adverse impact on the long- and short-term operations of United States business abroad. The payments have had detrimental effects on the "investment climate" for some United States based corporations in certain countries, resulting in threats or actual expropriation, halting compensation for corporate property previously expropriated, cancellation of investment contracts and concessions, loss of prospective sales in a country, and damage to the reputation of United States based corporations. These payments, therefore, are damaging to United States foreign economic policy objectives. Furthermore, certain contributions, payments, and gifts were made for the purpose of acquiring an unfair competitive advantage over either United States or foreign companies. As such, they are antithetical to the United States foreign economic policy objective of open, nondiscriminatory world trade and are acts in restraint of trade and unfair methods of competition. In a number of cases, the boards of directors of the corporations making such payments were not notified of such contributions, payments, and gifts; in no case were shareholders or the investing public informed.

(d) Therefore, it is the purpose of Congress to insure availability of adequate information to the boards of directors of corporations and to existing and potential investors. To this end, mechanisms are established to insure discovery of such information during the audit process and its transmittal to the board of directors and shareholders. The Securities and Exchange Commission is charged with collecting and providing such information to the investing public.

(e) The Congress of the United States also finds that contributions, payments, and gifts, illegal either under United States law or under foreign law are being used to reduce United States tax liability. Therefore, it is the purpose of Congress to insure the nondeductibility of such contributions, payments, and gifts.

(f) Finally, the Congress of the United States realizes that such practices by corporations also must be dealt with on an international scale. Provisions of this Act are designed to encourage the President of the United States to seek pertinent international agreements.

PAYMENTS TO FOREIGN PERSONS

SEC. 3. Subsection (a) of section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)) is amended, by adding at the end thereof, the following new paragraphs:

"(40) The term 'agent' when used in the context of payments to foreign persons by a company subject to the reporting requirements of this title,

means any person retained or employed by such company to perform such services on behalf of the company as the Commission may, by rule, define, including, but not limited to, promoting, selling, soliciting, or securing indications of interest for any product or service produced, sold, distributed, or performed by that company or any of its subsidiaries or affiliates.

"(4) The term 'foreign government' means the government of a country other than the United States, any political or local subdivision thereof, any agency or instrumentality of such a government or subdivision, and any politician, political party, or political association within a foreign country.".

SEC. 4. Subsection (a) of section 13 of the Securities Exchange Act of 1934 (15 U.S..C. 78m(a)) is amended, by adding after paragraph 2 thereof, the following new paragraphs:

"(3) a sworn disclosure statement containing such information and documents (and such copies thereof), certified by independent public accountants, as the Commission shall deem necessary or appropriate to provide a complete accounting of any offer or agreement of any agent or employee of a company or its parent, to make any contribution, pay any fee, or give anything of significant value in connection with—

"(A) direct and indirect political contributions to foreign governments;

"(B) direct and indirect payments and gifts to employees of foreign governments which are intended to influence the decisions of such employees and which are made either with or without the consent of their sovereign; and

"(C) direct and indirect payments and gifts to employees of foreign, nongovernmental purchasers and sellers which are intended to influence normal commercial decisions of their employer and which are made without the employer's knowledge or consent.

"(4) the disclosure statement required to be filed by paragraph (3) above shall be filed annually and shall include—

"(A) the name and address of each person who made such contributions, payment, or gift;

"(B) the date and amount of such contribution, payment, or gift;

"(C) the name and address of each recipient and beneficiary, direct and indirect, of each contribution, payment, or gift;

"(D) a description of the purpose for which such contribution, payment, or gift was furnished;

"(E) a statement whether the contribution, payment, or gift was legal where made;

"(F) identification of relevant foreign law when foreign law prevents filing information required by this Act, as stated in paragraphs (8) and (9); and

"(G) such other information as the Securities and Exchange Commission may by rule or regulation require as necessary or appropriate in furtherance of the purposes of the International Contributions, Payments, and Gifts Disclosure Act.

"(5) any company making contributions, payments, and gifts reported pursuant to paragraph (3) shall maintain related books and records for not less than five years.

"(6) no such contribution, payment, or gift may be made in connection with any transaction described in paragraph (3) through or by any agent or other person who has not first agreed to maintain, for not less than five years, copies of such books and records in the United States or to make available upon request by the company such books and records relevant to to said company to show the ultimate recipient of each such contribution, payment, or gift, whether furnished to such ultimate recipient directly or through another agent, subagent, or other intermediary.

"(7) the Securities and Exchange Commission shall promulgate such rules and regulations as it may deem necessary to carry out the provisions of the International Contributions, Payments, and Gifts Act.

"(8) whoever, unless prevented by foreign law, (a) knowingly fails to file a statement required by this section, (b) knowingly files a false statement, or (c) knowingly fails to obtain from any agent all information required for any disclosure statement under paragraph 3 of this Act, shall, upon conviction, be fined not more than $25,000 and imprisoned for not less than one month and not more than two years.

"(9) any person who signed the disclosure statement required by paragraph 3, any person who is a director of or partner in the company required to file such disclosure statement and any other person who, with his consent, has been named as having prepared or certified any part of such disclosure statement, or as having prepared or certified any statement or evaluation used in connection with the disclosure statement and who, unless prevented by foreign law, (a) knowingly fails to file a statement, (b) knowingly fails to obtain information required by this subsection, or (c) knowingly files a false statement, shall, upon conviction, be fined not more than $25,000 and imprisoned for not less than one month and not more than two years.

"(10) all information provided pursuant to paragraph 3 above shall be made available to the public unless the President determines public disclosure will severely impair the conduct of United States foreign policy. If the President makes this determination, this information shall be placed in a separate report and submitted to the Committee on Foreign Relations of the Senate and the International Relations Committee of the House. The fact that information has been deleted from the public record shall be noted on the public record."

FOREIGN POLICY ANALYSIS

SEC. 5. (a) The Secretary of State shall provide annually to the Committee on Foreign Relations of the Senate and the International Relations Committee of the House of Representatives a comprehensive review and foreign policy analysis by country, concerning companies—

(1) direct and indirect political contributions to foreign governments;

(2) direct and indirect payments and gifts to employees of foreign governments which are intended to influence the decisions of such employees either with or without the consent of their sovereign; and

(3) direct and indirect payments and gifts to employees of foreign, nongovernmental purchasers and sellers which are intended to influence normal commercial decisions of their employer and which are made without the employer's knowledge or consent.

(b) The report required by paragraph (a) shall contain—

(1) the aggregate value of such contributions, payments and gifts, if the total amount equals or exceeds a value determined by the Secretary of State as having significant foreign policy consequences, identification of the companies involved, and an analysis of foreign policy implications;

(2) a description and analysis of specific transactions whose effects are directly or indirectly detrimental to the interests of the United States;

(3) a statement of whether the Department of State was aware of such contributions, payments, and gifts prior to their making; and

(4) such other information as the Secretary of State deems necessary to provide a complete analysis of the foreign policy implications for the United States of the transactions involved.

(c) The Secretary of State shall have access to all information from the Securities and Exchange Commission he determines is relevant to the formulation of this report. Further, the Secretary of State may suggest to the Securities and Exchange Commission additional rules and regulations, for promulgation by the Securities and Exchange Commission, designed to obtain information for the Secretary's report. The Secretary of State may also request that the Securities and Exchange Commission seek supplementary information to enable the Secretary to provide as complete a report as possible.

(d) Nothing shall prevent the Secretary of State from making more frequent reports or briefings, partial or complete, when deemed necessary by either the Secretary of State or the Committee on Foreign Relations of the Senate or the International Relations Committee of the House.

DISCLOSURE OF INFORMATION ON ANNUAL REPORTS TO SHAREHOLDERS

SEC. 6. (a) Each company reporting pursuant to this Act shall disclose in its annual report—

(1) the aggregate values of contributions, payments, and gifts reported under each of subparagraphs (A), (B), and (C) of paragraph 3 of section 13(a) of the Securities and Exchange Commission Act of 1934, as amended above;

(2) a statement whether any of these payments, contributions, or gifts were illegal where made; and

(3) a statement that the information on specific transactions is publicly available at the Securities and Exchange Commission.

NONDEDUCTIBILITY OF ILLEGAL PAYMENTS BY FOREIGN CORPORATIONS AND DISCS

SEC. 7. (a) IN GENERAL.—Section 162(c) of part VI of subchapter B of chapter 1 of the Internal Revenue Code of 1954 (relating to illegal deductions) is amended by adding the following as a new paragraph (3) and redesignating present paragraph (3) as paragraph (4):

"(3) FOREIGN CORPORATIONS.—The provisions of paragraphs (1) and (2) shall apply in computing the earnings and profits of a foreign corporation for any taxable year.".

(b) DISCS.—Part VI of subchapter N (relating to Domestic International Sales Corporations) is amended by adding at the end thereof the following new section:

SEC. 998. NONDEDUCTIBILITY OF ILLEGAL PAYMENTS.

"The provisions of paragraphs (1), (2), and (3) of section 162(c) shall apply in computing the taxable income and earnings and profits of a DISC or former DISC for any taxable year.".

(c) CONFORMING AMENDMENTS.—

(1) Section 901(g) (relating to foreign tax credit cross references) is amended by adding at the end thereof the following new paragraph (5):

"(5) For nondeductibility of illegal payments in computing earnings and profits of foreign corporations and DISCS, see section 162(c)(3) and section 998.".

(2) Section 964(a) (relating to earnings and profits of controlled foreign corporations) is amended by adding after the words "section 312(m)(3)" and before the first comma the following new words: "and section 162(c)(3)".

(3) The table of sections for part IV of subchapter N is amended by adding at the end thereof the following new item:

"Sec. 998. Nondeductibility of illegal payments.".

(d) EFFECTIVE DATE.—The amendments made by this Act shall apply to taxable years beginning after December 31, 1976.

BOARD OF DIRECTORS, THE AUDIT COMMITTEE AND AUDITS

SEC. 8 (a) At least one-third, or three members, of each comany's board of directors shall be composed of independent outside directors—individuals having no direct or indirect financial ties with the company. These independent outside directors shall be elected by the shareholders.

(b) Among these responsibilities as full members of the board of directors, independent, outside board members shall constitute the audit committee of the board. The audit committee shall have the responsibility for initiating and pursuing internal investigations of company operations arising from this Act and may initiate and pursue other internal investigations. It shall report the results of any investigation to the board of directors and at the audit committee's discretion, to the shareholders, the Securities and Exchange Commission, and other relevant bodies. The audit committee shall hire independent auditors for the company and can hire counsel and other staff necessary to fulfill its responsibility. Those hired by the audit committee shall report to that committee.

(c) It is the responsibility of any independent auditor hired to inquire fully into any illegal, unusual, or questionable activities.

(d) Each member of the board of directors must provide the independent auditors with a signed, sworn statement that (1) he knows of no illegal or unusual payment that has not been reported to the independent auditors nor of any books or records of the company whose existence is not known by the independent auditors, and (2) he has no knowledge of any irreguiarities in areas of the firm's business that are difficult to audit.

(e) Independent auditors shall have civil recourse for actual damage against persons or companies who withhold or misrepresent information necessary for the auditor to carry out its responsibilities.

SHAREHOLDER'S RIGHT OF ACTION

SEC. 9. (a) Section 27 of the Securities Exchange Act of 1934 (15 U.S.C. 78aa) is amended, by designating existing section 27 as subsection (a) thereof, and adding, at the end thereof, the following new subsections:

"(b) Any person who can demonstrate actual damage in connection with the actual or proposed purchase or sale of any security or waste of assets resulting from—

"(1) the contributions, payments, or gifts described in the report required by paragraph 3 of subsection (a) of section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a)); or

"(2) the failure of compliance with any part of the International Contributions, Payments, and Gifts Disclosure Act or the rules and regulations thereof

may maintain an action, at law or in equity in accordance with subsection (a) of this section.

"(c) In the case of any successful action to enforce liabilities described in subsection (b) above, the court shall determine any liability for the costs of the action, and reasonable attorneys' fees.".

PRIVATE RIGHT OF ACTION

SEC. 10. Any person who can establish actual damage to his business resulting from illegal (as determined by United States law or the laws of the country in which the contribution, payment, or gift was made) contributions, payments, or gifts, made by a competitor and who has not made such illegal payments himself in a relevant time period, may maintain a cause of action against that competitor and, if successful, can recover—

(a) treble the actual damage accruing to his business activity; and

(b) costs of the action and reasonable attorney's fees as determined by the court.

INTERNATIONAL EFFORTS

SEC. 11. (a) All efforts should be made by the President to obtain international agreements in as many forums as appropriate concerning the reporting and exchange of this information and the establishment of international standards and codes of conduct for the operations of companies.

(b) The President shall make all efforts to obtain international rules and regulations for international government procurement and sales.

[S. 3418, 94th Cong., 2d sess.]

A BILL To amend the Securities Exchange Act of 1934 to prohibit certain issuers of securities from falsifying their books and records, and for related purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 13(b) of the Securities Exchange Act (15 U.S.C. 78m(b)), is amended by renumbering existing section 13(b) as section 13(b)(1), and by adding at the end of new section 13(b)(1), the following subparagraphs:

"(2) Every issuer which has a class of securities registered pursuant to section 12 of this title and every issuer which is required to file reports pursuant to section 15(d) of this title shall—

"(A) make and keep books, records, and accounts, which accurately and fairly reflect the transactions and dispositions of the assets of the issuer; and

"(B) devise and maintain an adequate system of internal accounting controls sufficient to provide reasonable assurances that—

"(i) transactions are executed in accordance with management's general or specific authorization;

"(ii) transactions are recorded as necessary (1) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements and (2) to maintain accountability for assets;

"(iii) access to assets is permitted only in accordance with management's authorization; and

"(iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

"(3) It shall be unlawful for any person, directly or indirectly, to falsify, or cause to be falsified, any book, record, account, or document, made or required to be made for any accounting purpose, of any issuer which has a class of securities registered pursuant to section 12 of this title or which is required to file reports pursuant to section 15(d) of this title.

"(4) It shall be unlawful for any person, directly or indirectly—

"(A) to make, or cause to be made, a materially false or misleading statement, or

"(B) to omit to state, or cause another person to omit to state, any material fact necessary in order to make statements made, in the light of the circumstances under which they were made, not misleading

to an accountant in connection with any examination or audit of an issuer which has a class of securities registered pursuant to section 12 of this title or which is required to file reports pursuant to section 15(d) of this title, or in connection with any examination or audit of an issuer with respect to an offering registered or to be registered under the Securities Act of 1933.".

APPENDIX

THE SECRETARY OF COMMERCE

WASHINGTON, D.C. 20230

June 11, 1976

Honorable William Proxmire
Chairman, Committee on Banking,
Housing and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Senator Proxmire:

In testifying before your Committee on April 8, 1976 I promised to provide you with comments on your proposed legislation concerning questionable corporate payments abroad. At that time, the Task Force on Questionable Corporate Payments Abroad had just been created (on March 31). In order to allow the Task Force time to perform relevant preliminary analysis of the issues involved -- and with the schedule of the Congress also in view -- we agreed that these comments should be provided by June 1. On May 19, you graciously agreed to my request that the June 1 date be changed to June 10. This letter provides comments in accord with our agreement.

Your bill, S. 3133, amends the Securities Exchange Act of 1934 and the Securities Act of 1933 to require disclosure of certain foreign payments and to provide for criminal prosecution of payments made to influence actions of foreign governments.

S. 3133 would require each issuer of a security registered with the Securities and Exchange Commission (SEC) to report to the SEC all payments in excess of $1,000 made to: (i) representatives or employees of foreign governments; (ii) any foreign political party or candidate for foreign office; or (iii) any person retained to assist with obtaining or maintaining business with, or influencing legislation or regulations of, a foreign government. S. 3133 requires that such reports be made publicly available and that they contain a statement of amount, purpose and the name of the recipient of each payment.

In addition, S. 3133 would amend the Securities Act of 1933 to allow the SEC to initiate, prosecute or appeal criminal actions against issuers who use the mails or any instrumentality of interstate commerce to pay or agree to pay or give anything of value to a foreign government official, agent or representative of such official or to any foreign political party or candidate, for the purpose of inducing such individual or party to use his or its influence with a foreign government "to obtain or maintain business for or with the issuer or to influence legislation or regulations of that government." Further, S. 3133 would make unlawful any payment made in a manner or for a purpose which is illegal under the laws of the foreign government having jurisdiction over the transaction.

In commenting upon your bill, this letter discusses the following:

(1) The Questionable Payments Problem

(2) Relevant Current Law

(3) The Current Administration Approach to Treatment of the Problem

(4) Alternative Approaches Which Might Supplement the Current Administration Approach

(5) Recommendations with Respect to the Need for Additional Legislation at this Time

(6) Conclusion

(1) The Questionable Payments Problem

As you know, the Task Force is charged with responsibility for policy development and not with responsibility for investigation. Ongoing investigative responsibilities rest with auditing agencies (e.g., the Defense Contract Auditing Agency), the Internal Revenue Service, the SEC, and the Department of Justice -- upon whose work the Task Force has drawn in its attempt better to understand the character and scope of the problem.

3

It is clear on the basis of information already at hand that the "questionable payments problem" is, in fact, real -- i.e., that:

-- A significant number of America's major corporations, in their dealings with foreign governments, have engaged in practices which violated ethical and in some cases legal standards of both the United States and foreign countries.

-- To carry out these practices, certain American corporations have falsified records, lied to auditors, and used off-the-books "slush" funds.

-- In some cases, improper foreign payments have been unlawfully deducted as ordinary and necessary business expenses for U.S. income tax purposes.

-- In the case of a number of major corporations, employment of improper business practices abroad has coincided with past illegal political contributions in the United States. (Some allege that a major area of abuse involves the possible direct connection between questionable payments abroad and illicit domestic payments.)

"The problem" is, of course, a set of problems -- often interrelated, but distinguishable, as follows:

-- The problem of "petty corruption." So-called "grease" or "facilitating" payments are a business requirement in a number of less developed countries -- where they are often culturally, if not legally, accepted as a means of remuneration for an underpaid civil service. Further, petty corruption is a "fact of life" -- although presumably to a lesser extent -- in many developed countries.

4

-- The problem of "competitive necessity." It is frequently argued that American firms are required to bribe in order to "out-compete" foreign competition. (While this hypothesis may be valid, no substantial evidence to support this hypothesis has, as yet, been presented to the Task Force. In several cases, payments have been made to intermediaries, but have not been transmitted to the intended governmental decision makers. In a number of questionable payments cases -- especially those involving sales of military and commercial aircraft -- payments have been made not to "out-compete" foreign competitors, but rather to gain an edge over other U.S. manufacturers.)

-- The problem of extortion. In some instances, improper payments have been extorted from U.S. companies by corrupt officials or agents purporting to speak for such officials.

-- The problem of adverse effect on foreign relations. The manner of disclosure of allegations regarding past practices, the substance of the allegations revealed, and in some cases the practices themselves, have had adverse impact on the political and social fabric of countries friendly to the United States -- and have, thereby, adversely affected U.S. foreign relations.

-- The problem of adverse impact on multinational corporations. Exposure of the questionable payments problem has exacerbated concerns about multinationals' accountability to the national legal constraints of both home and foreign "host" countries. It has raised the level of concern that such enterprises have the capacity to conduct independent foreign policy including the suborning of host country political and governmental processes. Increased anxiety regarding multinationals' legal and political accountability could lead to national and international "backlash" in the form of laws

or regulations which could seriously handicap such enterprises with resulting detriment to the United States economy, to world commerce and to the pattern of world development.

-- The problem of eroding confidence in "free" institutions. Revelations of questionable payments -- with off-book accounting -- may have undermined, to some degree, investor confidence in the adequacy of regulatory mechanisms intended to assure the provision of information necessary for the honest and efficient functioning of capital markets. The payments themselves may have distorted the allocation of resources within a would-be competitive system -- or, in some cases, may have distorted representation within a political system. But most fundamentally, the uncovering of these improper past practices has eroded confidence in corporate responsibility and in democratic and capitalist institutions generally.

At this stage, some would argue that the pattern of illegal and questionable behavior already exposed is highly atypical -- that most international corporations have conducted themselves as "good citizens." The SEC analysis indicates that at least 95 corporations have disclosed possible questionable or illegal payments. And the SEC would suggest that the actual scope of the problem is not likely to be significantly greater than that which has already been voluntarily revealed -- because criminal sanctions attach to the willful filing of a false or incomplete report, i.e., the incentive fully to disclose "voluntarily" has arguably been high.

Others argue that the pattern of voluntary disclosure to the SEC has shown corporations to have been less than wholly forthcoming -- that in many instances additional investigation has shown initial disclosures to have been inadequate. Some note further that SEC reporting requirements have not reached those companies whose counsel have, on one ground or another, advised against disclosure.

In short, the extent to which disclosures to date do or do not fully represent the scope of the problem remains in dispute. It is the current view of the Task Force and the President that the overwhelming majority of U.S. corporations do conduct themselves as good citizens -- and that they are to some extent now the victims of a public mood which alleges guilt-by-association.

More definitive delineation of the precise dimensions of the questionable payments problem must await further investigation by corporations investigating themselves with the approval of the SEC and the courts (the "Gulf model"), by the IRS whose intensified review of the problem is in its initial stages, by the Federal Trade Commission, and by the Department of Justice.

It is clear, however, that the nature of the problem -- and the extent of the problem as revealed to date -- are sufficient to justify the remedial measures already under way and serious consideration of possible additional measures.

(2) Relevant Current Law

The discussion which follows in sections (a) - (d) outlines current law and in section (e) analyzes its sufficiency for the task of deterring future improper payments by American firms abroad.

(a) Securities Laws

The securities laws are designed to protect investors from misrepresentation, deceit, and other fraudulent practices by requiring public disclosure of certain information pertaining to the issuers of securities. Such disclosure is accomplished, first, through the mechanism of a registration statement which is required to be filed with the SEC as a precondition to a public offering of securities pursuant to the Securities Act of 1933, 15 U.S.C. § 77a et seq. (1970), the "1933 Act;" and, second, through the annual and other periodic reports and proxy materials required to be filed by registered companies with the SEC pursuant to the Securities Exchange Act of 1934, 15 U.S.C. § 78a et seq. (1970), the "1934 Act."

7

There is no specific requirement that questionable payments to foreign officials be disclosed in registration statements filed pursuant to the 1933 Act or in the annual or periodic reports or proxy materials filed pursuant to the 1934 Act. However, in addition to the specific instructions and requirements incident to each of these filings, the SEC requires the disclosure of all material information concerning registered companies and of all information necessary to prevent other disclosures made from being misleading, e.g., 17 C.F.R. §§ 230.408, 240.12b-20, 240.14(a)-9(a)(1975). Thus, facts concerning questionable payments are required to be disclosed insofar as they are material.

Materiality has been defined by the SEC as limiting the information required "to those matters as to which an average prudent investor ought reasonably to be informed before purchasing the security registered." Rule 405(1), 17 C.F.R. § 230.405(1)(1975). The materiality of any fact is to be assessed, according to the courts, by determining:

> ". . . whether a reasonable man would attach importance [to it] . . . in determining his choice of action in the transaction in question. [Citation omitted.]" (Emphasis supplied.) This, of course, encompasses any fact ". . . which in reasonable and objective contemplation might affect the value of the corporation's stock or securities . . . [Citation omitted.]" (Emphasis supplied.) Thus, material facts include not only information disclosing the earnings and distributions of a company but also those facts which affect the probable future of the company and those which may affect the desire of investors to buy, sell, or hold the company's securities." SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968).

Alternatively stated, the test is whether ". . . a reasonable man might have considered . . . [the information] important in the making of [his] decision." Affiliated Ute Citizens v. United States, 406 U.S. 128, 153-54 (1972).

The courts have not yet addressed the issue of whether and under what circumstances questionable payments made by a U.S. corporation to foreign officials would be material

8

information which should be disclosed publicly.*/ Thus, the SEC, through its enforcement program and its voluntary disclosure program,**/ has been the sole arbiter as to the materiality of such payments.

The extent of the Commission's activities with respect to both foreign and domestic payments and practices has created a great deal of uncertainty as to how the materiality standard applies to improper foreign payments. The SEC has not issued a release containing disclosure guidelines on this subject to date. However, in a report submitted to your Committee on May 12, 1976, the SEC has given some guidance as to its current position ("Report of the Securities and Exchange Commission on Questionable and Illegal Corporate Payments and Practices).

In this Report, the SEC takes the position that questionable or illegal payments that are significant in amount or that, although not significant in amount, relate to a significant amount of business, are material and required to be disclosed. Other questionable payments may also be material, according to the Report, regardless of their size or the significance of the business to which they relate. Thus, the Report indicates (at page 15) that: ". . . the fact that corporate officials have been willing to make repeated illegal payments without board knowledge

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*/ The conviction of a director and chief executive officer of a company for bribing U.S. public officials has been held to be a material fact which should have been disclosed. Cooke v. Teleprompter Corp., 334 F. Supp. 467 (S.D.N.Y. 1971).

**/ In addition to its regular enforcement program, the SEC has established special procedures for registrants seeking guidance as to the proper disclosure of questionable foreign payments. These procedures, frequently referred to as the "voluntary disclosure program," provide a means whereby companies can seek the informal views of the Commission concerning the appropriate disclosure of certain matters. The program is intended to encourage publicly-owned corporations to discover, disclose, and terminate, on a voluntary basis, the making of questionable payments and related improper activities.

and without proper accounting raises questions regarding improper exercise of corporate authority and may also be a circumstance relevant to the 'quality of management' that should be disclosed to the shareholders."

Moreover, even if expressly approved by the board of directors, the Report states (at page 15) that ". . . a questionable or illegal payment could cause repercussions of an unknown nature which might extend far beyond the question of the significance either of the payment itself or the business directly dependent upon it" -- and for that reason might have to be disclosed.

(b) Tax Laws

Section 162(c) of the Internal Revenue Code provides that bribes and kickbacks, including payments to government officials, cannot be deducted in computing taxable income if the payment (wherever made) would be unlawful under U.S. law if made in the United States.

The principal mechanism for the detection of improper deductions is the corporate income tax return and, in the case of foreign subsidiaries and affiliates, certain information returns. Criminal and civil sanctions may be applicable if an improper payment is deducted from earnings.

The Internal Revenue Service (IRS) does not routinely require taxpayers to furnish information as to the payment of bribes or kickbacks. However, in August 1975, the IRS issued guidelines to its field examiners providing techniques and compliance checks to aid in the identification of schemes used by corporations to establish "slush funds" and other methods to circumvent federal tax laws. In April and May of 1976, additional instructions were issued focusing on illegal deductions of questionable payments to foreign officials abroad. The IRS is now engaged in investigating hundreds of the nation's largest companies regarding possible improper deductions of such payments and related tax improprieties.

(c) Antitrust Laws

The antitrust laws may have an impact on improper payments in a variety of ways. Depending on the factual circumstances, an improper payment could violate Sections 1 or 2 of the Sherman Act, 15 U.S.C. §§ 1, 2 (1970); Section 5

10

of the Federal Trade Commission Act, 15 U.S.C. § 45 (1970) the "FTC Act;" or Section 2(c) of the Clayton Act, the so-called brokerage provision of the Robinson-Patman Act, 15 U.S.C. § 13(c) (1970).

As a general rule, an American corporation which pays a bribe to gain favorable legislation abroad, or to facilitate a sale at the expense of a foreign competitor, will not be in violation of the U.S. antitrust laws. On the other hand, payment of a bribe by one U.S. company to assist its sales at the expense of another U.S. company may well be an unfair method of competition within the meaning of Section 5 of the FTC Act. A conspiracy among two or three U.S. companies to bribe a foreign official to keep another U.S. company out of an overseas market would probably violate Section 1 of the Sherman Act; however, it is not clear that an improper payment involving one firm and one government official can constitute a conspiracy for the purposes of this section. Bribes paid by one company for the purpose of monopolizing a foreign market might violate Section 2 of the Sherman Act.

Section 2(c) of the Clayton Act prohibits the payment of commissions or other allowances, except for services actually rendered, in connection with the sale of goods in which either the buyer or seller is engaged in commerce (including commerce with foreign nations). Section 2(c) encompasses commercial bribery and bribes of state government officials to secure business at the expense of U.S. competitors. Although there do not appear to be any Section 2(c) cases involving dealings with foreign governments, the statute might be applicable to the payment of a bribe by a U.S. corporation to a foreign official to assist its business at the expense of its U.S. competitor.

(d) Criminal Statutes and Other Laws

Present federal law does not prohibit, per se, bribery or similar questionable practices by American companies or persons with respect to foreign officials, companies, or persons in furtherance of commercial gain. However, criminal or civil liability may attach from collateral false reporting

11

practices. Most particularly, false statements filed with federal agencies may constitute a violation of 18 U.S.C. § 1001 (1970) or other specialized false statement statutes. Relevant provisions are summarized below:

(i) The Export-Import Bank of the United States (Eximbank). Certificates prepared by American firms whose goods are purchased with Export-Import Bank loans must declare any commissions, fees, or other costs above and beyond the actual value of the goods sold which constitute any part of the contract price. Several cases of possible fraud have recently been referred to the Criminal Fraud Section of the Department.

(ii) The Agency for International Development (AID). Under the Foreign Assistance Act, 22 U.S.C. § 2399 (1970), AID makes loans of hard currency available to foreign countries for purchase of American commodities for importation. An American exporter who makes a sale under this program must file a supplier's certificate with AID certifying that no kickbacks or commissions were paid. AID officials compare contract prices with current market prices and occasionally discover discrepancies requiring legal action, including referrals to the Department of Justice for possible fraud prosecutions. It has been held that a concealment of improper payments in AID forms constitutes a violation of the federal statute making it unlawful to conceal any matter within the jurisdiction of any United States department or agency, 18 U.S.C. § 1001 (1970). U.S. v. Olin Mathieson Chemical Corporation, 368 F.2d 525 (2d Cir. 1966).

(iii) State Department Export Licenses. Registered dealers may sell for export items on the U.S. Munitions List provided an export license is obtained from the State Department (22 C.F.R. § 121-27). The

12

application forms for such licenses require that the cost be listed, but without a breakdown. The International Security Assistance and Arms Export Control Act of 1976 (which was vetoed on May 7, 1976, but then reintroduced in altered form as S. 3439 and H.R. 13680) would add a new provision to the Foreign Military Sales Act, 22 U.S.C. § 2751 et seq. (1970), to require reports to the Secretary of State, pursuant to regulations issued by him, concerning political contributions, gifts, commissions and fees paid by any person in order to secure sales under Section 22 of the Foreign Military Sales Act. No such payment could be reimbursed under any U.S. procurement contract unless it was reasonable, allocable to the contract, and not made to someone who secured the sale in question through improper influence. Similar reporting requirements would be required with respect to commercial sales of defense articles or defense services licensed or approved under Section 38 of the Foreign Military Sales Act. All information reported and records kept would be available to Congress upon request and to any authorized U.S. agency. It should be noted that even at the present time, the Defense Department requires disclosure of all fees and commissions paid in the sale of military equipment pursuant to the Foreign Military Sales (FMS) program. False statements made pursuant to these disclosure requirements would constitute possible violations of 18 U.S.C. § 1001 (1970).

(iv) Securities and Exchange Commission. The failure to report in corporate financial statements filed with the SEC bribes and kick-backs to foreign officials or governments may constitute criminal fraud. However, to fall in that category under present law, the errors or omissions must have a material effect on the financial picture of the company as a whole as presented by the report.

In conjunction with violations in all of the foregoing areas, depending on the facts of a particular case, additional charges may be appropriate for conspiracy, 18 U.S.C. § 371 (1970), mail fraud, 18 U.S.C. § 1341 (1970), or fraud by wire, 18 U.S.C. § 1343 (1970). Furthermore, attempts to circumvent or defeat a regulatory system designed to ensure the integrity of a government program may constitute a conspiracy to defraud the United States.

(e) Analysis

The following analysis addresses the issue of whether new legislation is required to deal with improper corporate payments or whether the laws and regulations described above are, taken together, sufficient to deter such practices. Another way to state the question is whether the company that would consider the making of an improper payment -- or the foreign official that would demand one -- will be deterred from doing so by the existing laws and regulations.

The dimensions of the improper payments problem suggest, to some, the singular ineffectiveness of existing laws and regulations. On the other hand, some argue that the past failure of deterrence may be a function of insufficiently vigorous enforcement of existing authorities. My personal assessment is that even the most vigorous enforcement of existing law would not be an adequate solution to the problem, and that the shortcomings of existing law are the result of statutory and jurisdictional limitations rather than of enforcement policy.

It is clear that the provisions outlined above are insufficient to deal adequately with the questionable payment problem. Indeed, the requirements of the SEC are the only ones which, as a practical matter, deserve detailed consideration. For ease of presentation, it may be useful to discuss first the laws and regulations of lesser significance.

With respect to taxation and antitrust, both systems are theoretically applicable to all U.S. corporations doing business abroad but only to the extent that the making of a questionable payment also results in a violation of certain statutory prohibitions.

14

The tax laws only reach those transactions in which a questionable payment is deducted as a business expense. If a company making an improper payment does not take a deduction, the only source of potential liability arises from the maintenance of "slush funds" to circumvent federal tax laws generally. Although the IRS could require reporting of questionable payments, the information obtained could not be disclosed to the public because of the confidentiality of tax administration. Moreover, the mission of the IRS in the area of questionable payments abroad is to administer and enforce the tax law. All of the procedures and programs which the IRS has adopted, or might adopt in the future, are designed to accomplish that central objective -- the enforcement of the tax statutes.

The antitrust laws are generally inapplicable to an improper payment unless it can be shown that there is an anticompetitive effect on U.S. foreign commerce, for example, where a bribe is paid to exclude the product of a U.S. competitor or to monopolize a foreign market. There also exist substantial constraints to the justiciability and enforceability of applications of antitrust laws to foreign transactions. These include traditional legal doctrines regarding sovereign immunity of foreign governments and compulsion by foreign governments and consideration of comity between nations.

The Eximbank, AID, and FMS programs only apply to companies taking advantage of these particular programs. Moreover, none of them at the present time requires public disclosure. They are designed merely to ensure that the Government does not aid in the financing of questionable payments. In the case of the FMS program, pending legislation (as noted above) would provide for disclosure to the Congress but, in any case, it would still be limited to companies making sales of military equipment. Thus, as a practical matter, these programs taken together affect the actions of a limited number of companies doing business abroad and the FMS program, through its disclosure requirement (assuming passage of the new legislation), is the only one which contains a deterrent element.

There are several reasons why the SEC disclosure requirements may be inadequate to deter improper payments. First, they only apply to public companies, i.e., to companies with

securities registered under the 1934 Act or to companies making public offerings. Second, they only apply to the extent that the questionable payment is "material." Third, as a general rule, they do not require disclosure of the names of recipients of questionable payments. Fourth, they are not designed to protect adequately the interests that would be served by new legislation. Nonetheless, the utility of the SEC disclosure requirements must be examined in some detail, since the Commission itself believes that current securities laws are adequate to require sufficient disclosure of questionable payments and that any remaining problem can be solved by strengthening the corporate financial reporting system.

First, with respect to the coverage of the SEC program, there are at present approximately 9,000 corporations, not all of which do business abroad, which regularly file documents with the Commission. On the other hand, there are some 30,000 U.S. exporters and an additional number of U.S. firms doing business abroad which do not export from the United States. Indeed, some of the more important U.S. firms doing business abroad are private companies which are not subject to the SEC disclosure requirements.

Second, the Commission's authority to require disclosure is limited in that a questionable payment must be reported only if it is "material." On page 15 of its Report, the SEC sets forth the view that any payment, regardless of amount, may be "material" because it can lead to "repercussions of an unknown nature" or reflect on the quality or integrity of management. This very broad concept of materiality is at substantial variance with other recent discussions of materiality by the SEC. For instance, in facing the issue whether a company is required to report unlawful discrimination in employment, the SEC stated -- in a release issued less than one year ago -- that:

> "The Commission's experience over the years in proposing and framing disclosure requirements has not led it to question the basic decision of the Congress that insofar as investing is concerned the primary interest of investors is economic. After all, the

> principal, if not the only reason, why people invest their money in securities is to obtain a return. A variety of other motives are probably present in the investment decisions of numerous investors; but the only common thread is the hope for a satisfactory return, and it is to this that a disclosure scheme intended to be useful to all must be primarily addressed." Freeman, "The Legality of the SEC's Management Fraud Program," 31 Bus. Law. 1295, 1301 (March 1976).

In the same release the Commission stated that "there is no distinguishing feature which would justify the singling out of equal employment from among the myriad of other social matters in which investors may be interested." The release then listed 100 so-called social matters in which investors may be interested (including "activities which would be illegal in the U.S. but which are conducted abroad") but which, presumably, are not material per se. As stated not long ago by then Chairman Ray Garrett:

> ". . . as you can see, if you require disclosure of all violations of law against bribery or political contributions on the ground that illegal payments are material per se, we may be hard pressed to explain that other illegal corporate acts are not equally material for the same reason." Securities Act Release No. 5627, October 14, 1975, p. 37.

The Commission's current position with respect to questionable payments, however, seems to suggest the emergence of a new theory, namely, that with respect to illegal conduct the illegality itself is of consequence -- regardless of the nature of the offense and of its effect upon the value of the stockholder's investment. Indeed, with respect to questionable payments, it does not even appear to matter to the SEC whether they are actually illegal, that is, whether subject to indictment by prosecuting authorities in the United States or abroad. The Commission's enforcement policy in this area, however laudable, may be based on tenuous legal grounds. At the very least, given the extent of the Commission's enforcement activity, there is a good possibility that the matter will be presented to the courts.

17

The remarks of former SEC Chairman Garrett underscore the fact that the Commission's policy is a function of its composition at any particular time. New Commissioners may be disposed to take different interpretations. Thus, even assuming the legality or propriety of the views espoused by the present Commission, it is uncertain whether this will continue to be SEC policy. There may be virtue in a legislative scheme which does not depend for its viability on the continued zeal or militancy of its administrators.

Third, the SEC does not require disclosure of the names of the recipients of questionable payments, and it is hard to see how it could do so, at least in most cases, even under the most expansive interpretation of the materiality doctrine. The SEC Report states that while, in some cases, disclosure of the identity of the recipient might be important to an investor's understanding of the transaction, more frequently his identity may have little or no significance to the investor (at page 60).

More generally, the SEC system of disclosure is simply not adequate to the task at hand.

The questionable payments problem has sensitive and broad-ranging public policy and foreign relations implications. Moreover, it may be asked whether the SEC, in its expansive definition of materiality, has not raised serious questions as to the purpose and scope of the securities laws and the statutory role of the Commission. In remarks delivered in December 1975, then Commissioner Sommer urged the Commission to go slowly in expanding the area in which SEC disclosure becomes a substitute for the enforcement of other substantive laws. In particular, he pointed out that:

> ". . . Materiality is a concept that will bear virtually any burden; it can justify almost any disclosure; it can be expanded all but limitlessly. But we must constantly bear in mind that overloading it, unduly burdening it, excessively expanding it may result in signficant changes in the role of the Commission, the role of other enforcement agencies, and our ability to carry out our statutory duties." SEC News Digest, December 12, 1975.

Whatever definition is given "materiality" by the SEC or the courts, SEC disclosure is designed to protect the interests of the prudent investor. It is, arguably, not an appropriate mechanism to deal with the full array of national concerns caused by the problem of questionable payments.

(3) The Current Administration Approach to Treatment of the Problem

The current Administration approach is comprised of the following:

(a) Vigorous enforcement of current law (as summarized in (2) above).

Investigative enforcement activities are being conducted by audit agencies, the IRS, the Federal Trade Commission, the Department of Justice, and the SEC. The SEC has provided you with a Report based on the findings of its "voluntary program." As noted, the investigative activities of all these agencies are ongoing -- and the product of their investigations will continue to emerge in accord with fair and orderly legal process.

It is reasonable to conclude that the exposures to date have increased the attentiveness of responsible enforcement agencies in general -- and that they have increased the deterrent effect of current law thereby. A particularly noteworthy example is provided by the IRS's guidelines of May 10, 1976 -- requiring affidavits concerning "slush funds" and concerning bribes, kickbacks or other payments, regardless of form, made directly or indirectly to obtain favorable treatment in securing business or special concessions; or made for the use or benefit of, or for the purpose of opposing, any government, political party, candidate or committee.

(b) Pursuit of international agreements.

We anticipate endorsement of a code of conduct for multinational corporations at the coming Organization for Economic Cooperation and Development (OECD) Ministerial

Conference later this month. The code will include as agreed declaratory policy the following language:

"Enterprises should:

(i) not render -- and they should not be solicited or expected to render -- any bribe or other improper benefit, direct or indirect, to any public servant or holder of public office;

(ii) unless legally permissible, not make contributions to candidates for public office or to political organizations;

(iii) abstain from any improper involvement in local political activities."

Ambassador Dent has asked the General Agreement on Tariffs and Trade to take up the questionable payments issue, as called for in Senate Resolution 265. The resolution proposes negotiation in the Multilateral Trade Negotiations of an international agreement to curb "bribery, indirect payments, kickbacks, unethical political contributions and other such similar disreputable activities." The U.S. has indicated that negotiation of such an agreement is a matter of top priority.

Most significantly, the U.S. proposal for negotiation in the United Nations of a treaty on corrupt practices was made on March 5 at the second session of the UN Commission on Transnational Enterprises in Lima. The proposal is for an agreement to be based on the following principles:

(i) It would apply to international trade and investment transactions with governments, i.e., government procurement and other governmental actions affecting international trade and investment as may be agreed;

(ii) It would apply equally to those who offer to make improper payments and to those who request or accept them;

(iii) Importing governments would agree to establish clear guidelines concerning the use of agents in connection with government procurement and other covered transactions, and establish appropriate criminal penalties for defined corrupt practices by enterprises and officials in their territory;

(iv) All governments would cooperate and exchange information to help eradicate corrupt practices;

(v) Uniform provisions would be agreed upon for disclosure by enterprises, agents and officials of political contributions, gifts and payments made in connection with covered transactions.

The proposal was forwarded to the UN Economic and Social Council (ECOSOC) with a recommendation that ECOSOC give the issue priority consideration.

The U.S. objective is to have ECOSOC, at its July 12-August 6 meeting in Geneva, pass a resolution on corrupt practices which will create a group of experts charged with writing the text of a proposed international treaty on corrupt practices and reporting that text back to ECOSOC in the summer of 1977. The U.S. goal would then be to forward an agreed text to the UN General Assembly for action in the fall of 1977.

(c) Further policy development and coordination.

On March 31, 1976 the President established the Cabinet Task Force on Questionable Corporate Payments Abroad -- which, as you know, I chair. Members of the Task Force include: The Secretary of State; The Secretary of the Treasury; The Secretary of Defense; The Attorney General; The Special Representative for Trade Negotiations; The Director, Office of Management and Budget; The Assistant to the President for Economic Affairs; The Assistant to the President for National Security Affairs; and The Executive Director, Council on International Economic Policy.

In establishing the Task Force, the President said:

"Although the Federal Government is currently taking a number of international and domestic steps in an attempt to deal with this problem, I believe that a coordinated program to review these efforts and to explore additional avenues should be undertaken in the interest of ethical conduct in the international marketplace and the continued vitality of our free enterprise system."

The President directed the Task Force to coordinate further policy development concerning the questionable payments problem and to provide the President with interim status reports and a final report before the end of the calendar year.

The full Cabinet Task Force has met four times -- most recently, yesterday, with the President. Staff groups have prepared interim analyses of: current knowledge as to the character of the problem; pending legislative initiatives; possible alternative legislative initiatives; pending international initiatives; and possible supplementary international initiatives. We have consulted with a wide range of business representatives, legal experts, concerned U.S. citizens and foreign officials -- and, I should note, it is clear that there is a wide range of differing opinions within and among these groups.

The comments which follow reflect the thinking of the Task Force as developed to date -- except in those instances where I note my personal views or the specific decisions of the President.

(4) Alternative Approaches Which Might Supplement the Current Administration Approach

There are three broad categories in relation to which possible supplementary initiatives may be conceived: (a) further administrative initiatives within current law; (b) further international initiatives; and (c) further U.S. legislative initiatives. These categories, of course, are not mutually exclusive -- although alternative approaches within each category may be.

Within the first category, I include the stepped-up enforcement activities to which I have referred. In addition, the Task Force is now examining the need for changes in Executive Branch administrative operating procedures and guidelines.

But the basic premise from which I know you start is that current law is not sufficient -- a premise with which, as noted and qualified in (2) above, we would concur.

In our view, the ultimate legal basis for adequately addressing the questionable payments problem must be an international treaty along the lines proposed by the United States at the second session of the UN Commission on Transnational Enterprises in Lima. A treaty is required to make the "criminalization" of foreign bribery fully enforceable -- for, in the absence of foreign cooperation, it would be extremely difficult, and in many cases impossible, for U.S. law enforcement officials and potential defendants to be assured of access to relevant evidence. A treaty is also required to treat the actions of foreign as well as domestic parties to a questionable transaction. And a treaty is required to assure that all nations, and the competing firms of differing nations, are treated on the same basis.

However, a realistic assessment of prospects for international action would have to suggest that it is probable the desired international agreement may -- in spite of our best efforts -- take a considerable amount of time to achieve. International prospects are, in any case, highly uncertain.

In order to advance the prospects of favorable international action with respect to the U.S. proposal, the State Department has coordinated a special series of direct representations to foreign governments.

I am pleased to report that, in addition, the President has decided to accelerate progress toward an international agreement by direct efforts with our major trading partners. The U.S. Government -- the President in particular -- is serious about taking every reasonable step to achieve a responsible international agreement as quickly as possible.

It is with respect to U.S. legislation, then, that the question remains as to what else can and should be done.

The President and the Task Force have, as I have already noted, decided that current law is not sufficient to deal fully with the questionable payments problem. However, before outlining the legislative approach that we have decided upon, it is useful to review the considerations which underpin our choice of measures.

There are two principal competing general legislative approaches -- a disclosure approach or a criminal approach. While it is possible to design legislation -- as indeed is the case with S. 3133 -- which requires disclosure of foreign payments and makes certain payments criminal under U.S. law, the Task Force has unanimously rejected this approach. The disclosure-plus-criminalization scheme would, by its very ambition, be ineffective. The existence of criminal penalties for certain questionable payments would deter their disclosure and thus the positive value of the disclosure provisions would be reduced. In our opinion the two approaches cannot be compatibly joined.

The Task Force has given considerable scrutiny to the option of "criminalizing" under U.S. law improper payments made to foreign officials by U.S. corporations. Such legislation would represent the most forceful possible rhetorical assertion by the President and the Congress of our abhorrence of such conduct. It would place business executives on clear and unequivocal notice that such practices should stop. It would make it easier for some corporations to resist pressures to make questionable payments.

The Task Force has concluded, however, that the criminalization approach would represent little more than a policy assertion, for the enforcement of such a law would be very difficult if not impossible. Successful prosecution of offenses would typically depend upon witnesses and information beyond the reach of U.S. judicial process. Other nations, rather than assisting in such prosecutions, might resist cooperation because of considerations of national preference or sovereignty. Other nations might be especially offended if we sought to apply criminal sanctions to foreign-incorporated and/or foreign-managed subsidiaries of American corporations. The Task Force has concluded that unless reasonably enforceable criminal sanctions were devised, the criminal approach would represent poor public policy.

24

The Task Force did give serious consideration to one criminalization scheme, whereby the standards of U.S. law against official bribery would be applied to improper payments made abroad, provided the country in which such payments were made had entered a mutual enforcement assistance agreement with the United States and had enacted its own criminal prohibitions against official bribery. (A review by the Task Force reveals that practically every country in the world has a law against official bribery.) While such an approach to criminalization could be enforceable and would eliminate potential affronts to other nations' sovereignty, it would, however, apply only to payments made in countries willing to enter enforcement agreements with the U.S. -- whose number might not be large. In addition, as is the case with domestic bribery standards, it would entail the drawing of very difficult distinctions between criminal payments on the one hand and proper fees or political contributions on the other.

The Task Force has similarly analyzed the desirability of new legislation to require more systematic and informative reporting and disclosure than is provided by current law. The Task Force recognized that additional disclosure requirements could expand the paperwork burden of American businesses (depending upon the specific drafting) and that they might, in some cases, result in foreign relations problems -- to the extent the systematic reporting and disclosure failed to deter questionable payments and their publication proved embarrassing to friendly governments.

At the same time the Task Force perceived several very positive attributes of systematic disclosure. First, it deemed such disclosure necessary to supplement current SEC disclosure, which as noted already covers only issuers of securities making "material" payments, and does not normally include the name of the payee. Such disclosure would provide protection for U.S. businessmen from extortion and other improper pressures, since would-be extorters would have to be willing to risk the pressures which would result from disclosure of their actions to the U.S. public and to their own governments. It would avoid the difficult problems of defining and proving "bribery." It would offer a means to give public reassurance of the essential accountability of multinational corporations.

(5) Recommendations for Additional Legislation

Based upon analyses of the sufficiency of current law and of optional legislative approaches summarized above, the President has decided to recommend that the Congress enact legislation providing for full and systematic reporting and disclosure of payments made by American businesses with the intent of influencing, directly or indirectly, the conduct of foreign governmental officials. At the same time, the President has decided to oppose, as essentially unenforceable, legislation which would seek broad criminal proscription of improper payments made in foreign jurisdictions.

The President has directed the Task Force to draft this disclosure legislation for submission to Congress as soon as possible -- in order to allow Congressional action on the proposal in this session of Congress. The Task Force has not yet had an opportunity to develop, nor has the President had an opportunity to review, detailed specifications for such legislation. However, it is possible at this time to state in conceptual terms the basic outlines of the disclosure legislation which I would recommend:

-- All American business entities, whether or not they have securities registered with the SEC, would be required to report all payments in excess of some floor amount, made directly or indirectly to any person employed by or representing a foreign government or to any foreign political party or candidate for foreign political office in connection with obtaining or maintaining business with, or influencing the conduct of, a foreign government.

-- Such reports would include, at a minimum, the amount or value of the payment; its purpose; and the name of the recipient.

-- These reports would be required to be made to some Executive Branch department, such as the Department of Commerce or State and not the SEC.

-- The State Department, at its discretion would convey the contents of such reports to the affected foreign government. The reports would become available for public inspection after an appropriate interval, such as one year, to protect proprietary concerns and to allow opportunity for constructive diplomatic intervention prior to public controversy regarding a given payment.

-- Civil and/or criminal penalties would be set for negligent or willful failure to report. (Deliberate misrepresentation on such reports would be covered by current criminal law, 18 U.S.C. § 1001) (1970.)

-- The requirement for such reports would apply to all American business entities and through them to controlled foreign subsidiaries. Penalties for failure to report would apply only to U.S. parent corporations and their officers.

It is readily apparent that the approach outlined above in conceptual terms is, in a number of respects, similar to the disclosure portion of S. 3133. Our approach does differ, however, in at least one important respect. As already noted, reporting would not be made to the SEC. The SEC's jurisdiction, limited to "issuers" of registered securities, is inadequate to the problem. Further, the Task Force believes that the SEC would be an inappropriate agency for this reporting, which is directed at important national and foreign policy concerns and not simply to investor confidence.

The further extent to which the Administration's disclosure approach may differ from that embodied in S. 3133 remains to be determined through detailed drafting and the process of resolving points which remain at issue within the Task Force.

In addition to deciding to recommend the proposed new disclosure legislation, the President has decided to endorse the legislative approach to improved private sector internal reporting and accountability first proposed to your Committee by Chairman Hills in his Report of May 12 and recommended by the Task Force. That approach would:

-- prohibit falsification of corporate accounting records;

-- prohibit the making of false and misleading statements by corporate officials or agents to persons conducting audits of the company's books and records and financial operations;

-- require corporate management to establish and maintain its own system of internal accounting controls designed to provide reasonable assurances that corporate transactions are executed in accordance with management's general or specific authorization, and that such transactions are properly reflected on the corporation's books.

For reasons suggested above, I firmly believe that enactment of the disclosure and accountability legislative proposals, as recommended by the President, will provide the best approach to remedying the inadequacies of current law -- and to restoring confidence thereby. Should you or your colleagues wish, I would be happy to provide further elaboration of reasons for this belief --by whatever means may be most convenient to the Committee.

28

(6) Conclusion

Let me conclude with several summary points drawn from the above discussion:

(a) The questionable payments problem is serious -- as is the need for additional initiatives to address it. The improper actions of a few have not only disturbed foreign relations, but have caused a further erosion of confidence in American business and American institutions. Remedial actions taken to date have been insufficient to restore confidence.

(b) Although current investigative and enforcement activities are considerable, current law is not fully adequate to deter improper payments.

(c) The "disclosure" approach and the "criminalization" approach to additional legislation are not compatible with each other. For reasons stated, the Administration believes the disclosure approach to be a more effective and manageable means to deterrence.

(d) Although the preferred long-term approach to solution must be an enforceable international treaty (as proposed by the U.S. in Lima), the prospects for prompt adoption of such a treaty would, in the ordinary course, have to be viewed realistically as unlikely. There is a need for the U.S. to accelerate efforts to achieve its proposed international agreement.

(e) Accordingly, the President has reached the following decisions which are fully consistent with my own views:

(i) The President has decided to initiate special efforts to accelerate progress toward achievement of an international agreement -- along the lines proposed by the United Stated in Lima.

(ii) The President has decided to endorse legislation to assure the integrity of corporate reporting systems and the accountability of corporate officials -- legislation first proposed to your Committee by Chairman Hills in his Report of May 12.

(iii) The President has decided to propose additional legislation requiring reporting and disclosure of certain payments by U.S.-controlled corporations made with the intent of influencing, directly or indirectly, the conduct of foreign government officials.

We know you share with us a conviction that what is fundamentally at stake is not merely the impropriety of certain financial transactions. What is at stake ultimately is confidence in, and respect for, American business, American institutions, American principles -- indeed, the very democratic political values and free competitive economic system which we view as the essence of our most proud heritage and our most promising future. With this in view, we look forward to working with you and your colleagues toward enactment of legislation which will best serve the fundamental public interests which require a responsible solution to the questionable payments problem.

Sincerely,

Elliot L. Richardson

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